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Hofmann/Tams (eds.) • The International Convention on the Settlement of Investment Disputes (ICSID)

7

Schriften zur Europäischen Integration und Internationalen Wirtschaftsordnung 7

Rainer Hofmann/Christian J. Tams (eds.)

The International Convention on the Settlement of Investment Disputes (ICSID)

Taking Stock after 40 Years

Nomos

Schriften zur
Europäischen Integration und
Internationalen Wirtschaftsordnung

Veröffentlichungen des
Wilhelm Merton-Zentrums für Europäische Integration und
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herausgegeben von

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FOREWORD

On 18 October 1966, the International Convention on the Settlement of Investment Disputes (ICSID) entered into force. After a rather slow start, the system of mixed dispute settlement established by the ICSID Convention has begun to develop at a remarkable pace and is today rightly seen as a corner-stone of international dispute settlement in the field of international economic law. In addition to its immense practical relevance, international investment arbitration has developed in such a way that it is – equally rightly – held to be one of the intellectually most fascinating and challenging areas of modern international law. Consequently, the Wilhelm Merton Center for European Integration and International Economic Order has always considered international investment law to be one of its major fields of scholarly interest.

Therefore, its directors strongly welcomed the initiative taken by Dr. *Christian J. Tams*, Senior Research Assistant with the Walther Schücking Institute for International Law at the University of Kiel, to organise a symposium on current issues of ICSID law. This symposium took place on 26 – 28 April 2006 in Frankfurt am Main, and brought together a large number of investment experts from all over Europe. Opened with a keynote speech by Professor Dr. *Christoph Schreuer*, University of Vienna, who gave a general assessment of modern developments in investment law, the symposium was designed to allow six younger scholars and practitioners to present papers on salient issues of ICSID law. The ensuing discussions were initiated by comments from more experienced participants, again from both academia and practice. The present volume brings together the keynote speech as well as these various papers and comments, and, it is hoped, will give readers a good insight into the major problems currently faced by international investment arbitration under the ICSID Convention.

The directors of the Wilhelm Merton Center wish to use this opportunity to express their sincere gratitude to the Frankfurt am Main based sponsors of this symposium, namely Baker & McKenzie, Clifford Chance LLP, Freshfields Bruckhaus Deringer, Lovells, and Shearman & Sterling LLP, for their financial support. They also wish to thank Dr. *Christian J. Tams* for his strong and continuous intellectual input throughout the project. Finally, the editors of this volume wish to thank Ms *Christina Pfaff*, LL.M., for her most valuable assistance before, during and after the symposium, and Mr *Gennadi Rudak* for his editorial skills.

Frankfurt am Main, 25 January 2007

Rainer Hofmann Stefan Kadelbach Rainer Klump

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Introduction: The International Convention on the Settlement of Investment Disputes (ICSID) – Taking Stock after 40 Years

Rainer Hofmann/Christian J. Tams[*]

Forty years ago, on 18 October 1966, the International Convention on the Settlement of Investment Disputes (ICSID) entered into force. It was quickly ratified by a rather large number of States and was received very favourably by most commentators, one of whom, *Georg Schwarzenberger* (not otherwise known for over-enthusiasm or idealism), considered it a "remarkable" and "astounding" "essay in multilateral law-making".[1] Notwithstanding this positive assessment, and the great expectations coming with it, ICSID dispute settlement took a very slow start and for a long while looked destined to fail. Few cases were brought in the 1970s and 1980s, and those that were often dragged on for years before an eventual award was rendered (which then faced the risk of annulment by *ad hoc* committees).

As is well-known, the pendulum has swung back again, and most commentators today would happily subscribe to *Schwarzenberger's* initial assessment. From the 1990s, the system of mixed dispute settlement established by the ICSID Convention has begun to develop at a remarkable pace. The simplest, and yet most impressive, figure attesting to that development is the number of cases submitted to dispute settlement by ICSID arbitral tribunals. Whereas there tended to be an average of one case per year in the period between 1966-1996, the last decade has witnessed a sharp increase in the number of ICSID proceedings, with currently 108 cases pending before arbitral tribunals.[2] There is no shortage of metaphors describing this dynamic, or frantic, development. Some have spoken of a “baby-boom” of investment arbitration,[3] while others have likened ICSID to Sleeping Beauty, kissed awake by Prince Charming some time during the 1990s.[4] But apart from inspiring writers to use

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1 *Schwarzenberger*, Foreign Investments and International Law (1969), at p. 152.

2 See the list of cases provided on the ICSID website: http://www.worldbank.org/icsid/cases/pending.htm (visited 19 January 2007).

3 *Alexandrov*, 'The "Baby Boom" of Treaty-based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*', The Law and Practice of International Courts and Tribunals 4 (2005) , pp. 19.

4 *Obadia*, “ICSID, Investment treaties and Arbitration: Current and Emerging Issues”, in ICSID News, Vol. 18/2 (2001), available at http://www.worldbank.org/icsid/news/n-18-2-4.htm.

flowery language, investment law, with increasing numbers of ICSID proceedings and increasing amounts of damages sought, has gained an immense practical relevance, while also raising ever more complex conceptual issues.

While the pace of this development is astonishing, ICSID's increase in relevance has been facilitated by a number of factors. Two of them are regularly mentioned and remain valid. (i) The conclusion, by States, of ever more (bilateral and multilateral) investment treaties providing for dispute settlement by ICSID arbitral tribunals, has been decisive, as has been (ii) the solid increase in foreign investment. But these 'structural' reasons alone cannot explain the flood of new cases submitted to ICSID arbitration. As anyone looking at the list of pending ICSID cases will quickly realise, one particular State's economic policy has been equally influential: Argentina's response to the economic crisis of 2000-2002 is responsible for more than 1/3 of the proceedings currently pending, and without it, the increase in the number of ICSID proceedings (while still impressive) would be less astounding. In addition, though this is not always fully appreciated, ICSID arbitral tribunals themselves have played an important part. When called upon to interpret and apply key concepts of investment protection, they have generally adopted rather expansive approaches. Recent ICSID jurisprudence has notably widened the notion of 'investment' and has adopted an broad analysis of core substantive standards of investment protection (e.g. expropriation or fair and equitable treatment). In addition, arbitral tribunals have relied on umbrella clauses found in many bilateral investment treaties to widen the circle of potential claimants, and have also embraced claims by minority shareholders. This in turn has greatly expanded the scope of ICSID arbitration, both *ratione personae* and *ratione materiae* – not always to the liking of States, and at times provoking harsh responses by governments suffering defeats before ICSID arbitral tribunals.

At the same time, the developments sketched out in the preceding paragraphs have changed the character of investment arbitration: ICSID arbitration is no longer seen as the prerogative of a handful of specialists, but faces new challenges. Among them is what might be called the *challenge of legitimacy*, fuelling demands for a more transparent process of dispute settlement and a move away from traditional and confidential proceedings behind closed doors, especially in proceedings involving questions of environmental protection or labour standards. To exemplify the perception of investment arbitration as illegitimate, it may be helpful simply to cite *Anthony DePalma*'s oft-quoted remark about the working of investment tribunals: "Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a group of international tribunals handles disputes between investors and foreign governments can lead to national laws being revoked and environmental regulations changed. And it is all in the name of protecting foreign investors under NAFTA."[5]

5 *DePalma*, 'NAFTA's Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say', in: New York Times, 11 March 2001, Section 3, p. 1.

But legitimacy is not the only challenge facing investment arbitration. Another challenge is that of *(in)consistency*: a mechanism relying on *ad hoc* tribunals runs a considerable risk of producing inconsistent awards. Even in the 1970s or 1980s, when few cases were submitted, that risk of course could never be completely avoided; however, with proceedings mushrooming, it seems more acute than ever and can no longer be neglected. In fact, ICSID tribunals have openly criticised previous awards, and some of the decisions involving similar or identical questions of law and fact seem to hard to square. This in turn endangers the reliability and predictability of ICSID dispute settlement, *i.e.* reasons for which the mechanism has been established in the first place.

Finally, ICSID faces a *challenge of coordination*: paraphrasing a famous dictum about WTO law, one might say that investment law "cannot be read in clinical isolation",[6] or that in any event, that its days of splendid isolationism are over. ICSID tribunals regularly apply the rules of State responsibility, cite decisions of other international courts and tribunals, and interpret treaties according to the general rules of treaty interpretation. Conversely, ICSID jurisprudence contributes (and is increasingly recognised as a contributing element) to the development of international law generally. What is more, ICSID dispute settlement does not exist in isolation either. Given the continued debate about the role of investment within the WTO framework, ICSID might turn out to be an attractive forum for the litigation of some violations of WTO law. At the same time, bearing in mind the close connection between investment protection and property rights, investors that fail to establish standing before ICSID tribunals might eventually be tempted to seek relief before human rights institutions.

The papers put together in the present volume do not purport to analyse these developments exhaustively. Yet they address some of the more important controversies facing the ICSID Convention's dispute settlement mechanism as it enters its fifth decade. They have grown out of a conference convened by the *Wilhelm Merton Center* at the University of Frankfurt, on 25-27 April 2006, which brought together academics and practitioners with an interest in investment arbitration.

As the conference, the book opens with "The Dynamic Evolution of the ICSID System" by *Christoph Schreuer*. This paper, which was the keynote speech of the conference, provides a general assessment of modern developments in investment law (fittingly, given the number of Argentine cases, following the moves of a tango). Situating the ICSID Convention in the broader historical context, *Schreuer* stresses the many advantages of investment arbitration, which provides for conditions conducive to foreign investment, while also helping to defuse political tensions between developing and industrialised countries. However he also underlines that, faced with concerns by host States, ICSID must remind some of its clients of these benefits, and must avoid to be perceived as a one-sided mechanism favouring investors.

6 Cf. the WTO Appellate Body, United States - Standards for Reformulated and Conventional Gasoline (WT/DS2/AB/R), p. 17.

Schreuer's introduction is followed by three papers exploring reasons of ICSID's recent popularity. *Stephan Schill's* paper (with comments by *Kaj Hober* and *Jo Delaney*) provides a detailed analysis of the fair and equitable treatment standard. Although found in a great number of bi- and multilateral investment treaties, that standard has been unduly neglected in the literature. *Schill* identifies its core elements and shows that it emerges as one of the key concepts in international investment law.

Next in line is *Richard Happ* (with comments by *Michael Kerling* and *Anthony Sinclair*) who addresses two concepts that traditionally were considered to restrict the competence of ICSID tribunals, namely the 'foreign nationality' requirement and the 'exhaustion of local remedies' clause. Assessing recent ICSID jurisprudence, *Happ* notably shows that arbitral tribunals have yet to find a consistent and convincing approach to claims by companies controlled by nationals of the host State (as in the case of *Tokios Tokeles*[7]), or to claims by companies that are mere shells.

Alexander Szodruch then deals with a more specific problem, but one of immense practical and conceptual interest: that is the problem raised by the insolvency of a host State. In his paper (commented on by *Peter Gnam* and *August Reinisch)*, he analyses the legal standards applicable to Argentina's *pesification* measures and, *inter alia,* clarifies how arbitral tribunals have rejected Argentina's defence based on the concept of 'necessity'. Beyond that, he shows how the present debate forces us to abandon cherished distinctions between the law of international investment and the international finance, and inquires how State insolvency could change (and could be changed by) investment law.

The final three chapters then take up the different challenges to ICSID dispute settlement alluded to above. *Carl Zöllner's* paper (with comments by *Karl-Heinz Böckstiegel* and *Noah Rubins*), analyses what has been called the *challenge of legitimacy,* and in so doing offers a first analysis of the recent ICSID institutional reform debate. *Zöllner* argues that transparency and broader public participation are vital in ensuring the acceptance and democratic legitimacy of investment arbitration and could also foster coherence in international investment law. This approach also leads him to welcome recent ICSID decisions admitting *amicus curiae* briefs[8] and the results of the recent reform of the ICSID Arbitration Rules.

Christian J. Tams (with comments by *Richard H. Kreindler* and *Asif H. Qureshi*) then inquires whether "There [Is] a Need for an ICSID Appellate Structure?", thus assessing whether faced with a *challenge of (in)consistency*, investment arbitration

7 *Tokios Tokeles v. Ukraine* (Case No. ARB/02/18), Decision on Jurisdiction of 29 April 2004 (*Weil* (presiding), *Bernardini*, *Price*).

8 *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A., and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae* (19 May 2005); *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as *Amicus Curiae* (17 March 2006).

should move towards a two-level system of dispute settlement. He suggests that at present, there are no compelling reasons to move towards an investment appellate structure. Instead, the risk of inconsistency could be reduced by consolidating cases or ICJ proceedings, or (if a reform should prove unavoidable) through the introduction of a reference procedure along the lines of Art. 234 TEC.

Finally, *Christina Pfaff's* paper (with comments by *Rudolf Dolzer* and *Sabine Konrad*) leaves the framework of ICSID arbitration proper. Taking up the *challenge of coordination*, it discusses the role (if any) that human rights institutions and also the WTO may play in the process of investment protection. While noting that there is a potential for overlap, *Pfaff* stresses the advantages of ICSID arbitration and argues that human rights institutions or the WTO are unable to safeguard foreign investment effectively.

Taken together, the seven papers and twelve comments provide a broad spectre of views on the current state of dispute settlement under the ICSID Convention. Readers expecting one single grand theory explaining the successes and failures of forty years of ICSID dispute settlement will look in vain. Yet the contributions to the present volume underline reasons for ICSID remarkable success and highlight future challenges. It is the editors' hope that in addition, at least implicitly, they will convince readers that investment arbitration is rightly regarded as one of the most fascinating areas of modern international law.

The Dynamic Evolution of the ICSID System

Christoph Schreuer[*]

A. Investment and Development

There is broad consensus, that private investment is the most important factor in economic development. This has led most developing countries to revise their previously reserved attitudes towards FDI and to adopt an open and welcoming attitude towards foreign investors.[1]

Much of the investment climate in a country will consist of economic and political factors such as market access, the availability and cost of production factors, taxation, the existence of infrastructures, the existence of a functioning public administration, the level of corruption and political stability.

In addition to economic and political factors, the legal framework for FDI is also important in determining its investment climate. A particularly important aspect of the legal protection of foreign investments is the settlement of disputes between host States and foreign investors. Impartial and effective dispute settlement is an essential element in the protection of investments.

B. Protecting Foreign Investments - Procedural Alternatives

In the absence of other arrangements, a dispute between a host State and a foreign investor will normally be settled by the domestic courts of the host State. From the investor's perspective, this type of dispute settlement carries important disadvantages. Rightly or wrongly, the courts of the host State are often not seen as sufficiently impartial in this type of situation. In addition, domestic courts are bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes.

Domestic courts of other States are usually not a realistic alternative. In most cases, they will lack territorial jurisdiction over investment operations taking place in another country. In addition, sovereign immunity and other judicial doctrines will usually make such proceedings impossible.

* *Christoph Schreuer* is Professor of International Law at the University of Vienna, Austria.

1 See World Investment Report 2003, FDI Policies for Development: National and International Perspectives, UNCTAD (2003).

Diplomatic protection was a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in the relations of the States concerned.

Today, direct arbitration between the host State and the foreign investor is the preferred option for the settlement of investment disputes. International arbitration provides an attractive alternative to the settlement of investment disputes by national courts or through diplomatic protection. Arbitration is usually less costly and more efficient than litigation through regular courts. It offers the parties the opportunity to select arbitrators who enjoy their confidence and who have the necessary expertise in the field. Moreover, the private nature of arbitration, assuring the confidentiality of proceedings, is often valued by parties to major economic development projects.

If arbitration is not supported by a particular arbitration institution, it is referred to as *ad hoc* arbitration. *Ad hoc* arbitration requires an arbitration agreement that regulates a number of issues. These include the selection of arbitrators, the applicable law and a large number of procedural questions. A number of institutions, like UNCITRAL, have developed standard rules that may be incorporated into the parties' agreement. But *Ad hoc* arbitration is subject to the rules of the arbitration law of the country in which the tribunal has its seat. The enforcement of awards rendered by such tribunals is subject to the same rules as awards by tribunals dealing with commercial cases.

C. Tango: Two Steps Forward - One Step Back

I. Step One: The ICSID Convention

In this situation, the ICSID Convention[2] was a major step forward. It is designed to close an important procedural gap. It was drafted in the 1960ies and entered into force in 1966. It currently has 143 Parties.

2 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 575 UNTS 159 (1966); 4 ILM 532 (1965).

1. Purpose and Advantages

The idea of the ICSID Convention is to stimulate investment and hence economic development[3] by improving the standard of protection for foreign investments and the overall investment climate.

Compared to *ad hoc* arbitration, the ICSID Convention offers considerable advantages: it offers a system for dispute settlement that contains not only standard clauses for submission and rules of procedure but also institutional support for the conduct of proceedings. It assures the non-frustration of proceedings and provides for an award's recognition and enforcement.

2. Jurisdiction

The ICSID Convention is specialized in the settlement of investment disputes. Therefore, the existence of a legal dispute arising directly out of an investment is a prerequisite for ICSID's jurisdiction.[4] The concept of an investment is not defined in the Convention but many BITs and multilateral treaties contain definitions of investment.

In actual practice, the concept of "investment" has been given a wide meaning. A variety of activities in a large number of economic fields have been accepted as investments. In addition to traditional typical investment activities, these include pure financial instruments like the purchase of government bonds and the extension of loans.[5] They also include civil engineering contracts like the construction of a highway[6] and certain other services.[7] Decisive criteria are a certain duration of the relevant activities, an element of profit, the presence of a certain economic risk, a substantial commitment as well as the relevance of the project for the host State's development.

Proceedings under the Convention are always mixed. One party (the host State) must be a State party to the Convention. The other party (the investor) must be a national of another Contracting State. Either party may initiate the proceedings but in actual practice it is nearly always the investor who is the claimant.

3 ICSID Convention, Preamble, para. 1.

4 ICSID Convention, Article 25(1).

5 *Fedax* v. *Venezuela*, Decision on Jurisdiction, 11 July 1997, 5 ICSID Reports 186; *Československá Obchodní Banka A.S.* v. *Slovakia*, Decision on Jurisdiction, 24 May 1999, 5 ICSID Reports 335; *CDC* v. *Seychelles*, Award, 17 December 2003.

6 *Salini Costruttori* v. *Morocco*, Decision on Jurisdiction, 23 June 2001, 42 ILM 609 (2003); *Bayindir* v. *Pakistan*, Decision on Jurisdiction, 14 November 2005.

7 *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406; *SGS* v. *Philippines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518.

An additional requirement is that the investor must not be a national of the host State. But if a foreign investor operates through a company that is registered in the host State, it is possible for the investor and the host State to agree that the company will be treated as a foreign investor because of foreign control.[8] The nationality requirements under the ICSID Convention as well as under bilateral treaties have led to some creative nationality planning. For instance, an investor may create a company in a particular State for the primary purpose of gaining access to international arbitration.

Access to investment arbitration, including ICSID arbitration, requires consent to jurisdiction by both parties. Participation in the ICSID Convention does not amount to consent to jurisdiction.[9] This consent may be given in several ways. Consent may be contained in a direct agreement between the investor and the host State such as a concession contract. Alternatively, the basis for consent can be a standing offer by the host State which may be accepted by the investor in appropriate form. Such a standing offer may be contained in the host State's legislation. A standing offer may also be contained in a treaty to which the host State and the investor's State of nationality are parties. Most BITs and some regional treaties dealing with investments contain such offers. The more recent cases that have come before ICSID show a trend away from consent through direct agreement between the parties towards consent through a general offer by the host State which is later accepted by the investor often simply through instituting proceedings.

3. Characteristics

Proceedings under the ICSID Convention are self-contained. This means that they are independent of the intervention of any outside bodies. In particular, domestic courts have no power to stay, to compel or to otherwise influence ICSID proceedings.[10] Domestic courts would have the power to order provisional measures only in the unlikely case that the parties agree thereto.[11] An annulment or other form of review of an ICSID award by a domestic court is impermissible.

The principle of non-frustration means that a case will proceed even if one party fails to cooperate. This circumstance alone will be a strong incentive to cooperate. ICSID proceedings are not threatened by the non-cooperation of a party. If one of the parties should fail to act, the proceedings will not be stalled. The Convention provides a watertight system against the frustration of proceedings by a recalcitrant party. *E.g.*: arbitrators not appointed by the parties will be appointed by the Centre[12];

8 Article 25(2)(b) of the Convention.
9 ICSID Convention, Preamble, para. 7.
10 Article 26 of the Convention.
11 ICSID Arbitration Rules Article 39(6).
12 Article 38 of the Convention.

the decision on whether there is jurisdiction in a particular case is with the tribunal[13]; non-submission of memorials or non-appearance at hearings by a party will not stall the proceedings[14]; non-cooperation by a party will not affect the award's binding force and enforceability.

The system of arbitration is highly effective. This effectiveness is the result of several factors: Submission to ICSID's Jurisdiction is voluntary but once it has been given it may not be withdrawn unilaterally.[15]

Awards are binding and final and not subject to review except under the narrow conditions provided by the Convention itself.[16] Non-compliance with an award by a State would be a breach of the Convention and would lead to a revival of the right to diplomatic protection by the investor's State of nationality.[17]

The Convention provides an effective system of enforcement. Awards are recognized as final in all States parties to the Convention. The pecuniary obligations arising from awards are to be enforced like final judgements of the local courts in all States parties to the Convention.[18] Domestic courts have no power to review ICSID awards in the course of their enforcement. However, in the case of an award against a State the normal rules on immunity from execution will apply.[19] In actual practice this will usually mean that execution is not possible against assets that serve the State's public functions.

The system of dispute settlement under the ICSID Convention is likely to have an effect even without its actual use. The mere availability of an effective remedy will influence the behaviour of parties to potential disputes. It is likely to have a restraining influence on investors as well as on host States. Both sides will try to avoid actions that might involve them in arbitration that they are likely to lose. In addition, the prospect of litigation will strengthen the parties' willingness to settle a dispute amicably.

4. Caseload

ICSID had a slow start. The Convention entered into force in 1966 but the fist case was not registered before 1972. The 1970ies and 1980ies saw steady but only intermittent action. One or two cases per year were typical for that period.

The last ten years have seen a dramatic increase in activity. In 1995 there were four ICSID arbitrations pending. Today (26 April 2006) more than 100 are pend-

13 Article 41 of the Convention.
14 Article 45 of the Convention.
15 Article 25(1) of the Convention.
16 Article 53(1) of the Convention.
17 Article 27(1) of the Convention.
18 Article 54(1) of the Convention.
19 Article 55 of the Convention.

ing.[20] During 2005 27 new cases were registered. Therefore, more than two new cases per month are registered on average.

II. Step Two: The BIT Regime

1. Consent to Jurisdiction

A second big step forward in investment arbitration was the discovery and use of bilateral investment treaties (BITs) as basis for jurisdiction in investment arbitration. BITs have existed for some time. But their number has increased enormously during the 1990ies. In addition, regional treaties such as NAFTA and ECT also offer jurisdiction.

In the earlier cases of investor-State arbitration jurisdiction was always based on contracts between investors and host States. During the last 10 years most cases were brought on the basis of treaty provisions. [21] This has led to an enormous increase in the number of cases. It has also changed the character of the cases.

The vast majority of BITs contain clauses referring to investor-State arbitration. The States parties to the BIT offer consent to arbitration to investors who are nationnals of the other contracting party.

The dispute settlement clauses in many BITs offer several possibilities. These may include the domestic courts of the host State, procedures agreed to by the parties to the dispute, ICSID arbitration, ICC arbitration, and *ad hoc* arbitration often under the UNCITRAL rules.

A provision on consent to arbitration in a BIT is merely an offer by the respective States that requires acceptance by the other party. The arbitration agreement is perfected through the acceptance of that offer by an eligible investor, *i.e*. a national of the other State party to the BIT.

It is established practice that an investor may accept an offer of consent contained in a BIT by instituting ICSID proceedings. Therefore, where a BIT of this kind is in place, an investor no longer needs a formal arbitration agreement with the host State but can simply invoke the BIT. The Tribunal in *Generation Ukraine* v. *Ukraine* said:

"... it is firmly established that an investor can accept a State's offer of ICSID arbitration contained in a bilateral investment treaty by instituting ICSID proceedings. There is nothing in the BIT to suggest that the investor must communicate its consent in a different form directly to the State; ... It follows that the Claimant validly

20 For detailed information on pending cases see: http://www.worldbank.org/icsid/cases/pending.htm.

21 The first case in which consent was based on a BIT was *AAPL* v. *Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 250.

consented to ICSID arbitration by filing its Notice of Arbitration at the ICSID Centre."[22]

Treaty clauses providing for investor/State arbitration vary in scope. Some refer to all disputes concerning investments. Other treaties just refer to violations of the treaty itself. For instance, both the NAFTA[23] and the ECT[24] offer arbitration just for violations of the respective treaty itself.

Some BITs offer consent to jurisdiction in narrow terms. For instance, most BITs of China only offer jurisdiction for disputes about the amount of compensation for expropriation owed to an investor. But in China's most recent BITs (notably with Germany) jurisdiction extends to any dispute with respect to investment.

2. Umbrella Clauses

The scope of consent offered in a BIT may also be affected by an umbrella clause contained in the treaty. An umbrella clause is a provision in a treaty under which the States parties undertake to observe any obligations they may have entered into with respect to investments. In other words, contractual obligations are put under the treaty's protective umbrella. After some initial hesitation, most tribunals have now accepted that under the regime of an umbrella clause, violations of the contract become treaty violations.[25] Therefore, a provision in a BIT offering consent to arbitration for violations of the BIT extends to contract violations covered by the umbrella clause.

3. MFN Clauses

Most BITs and some other treaties for the protection of investment[26] contain most favoured nation or MFN clauses. A MFN clause contained in a treaty will extend the better treatment granted to a third State or its nationals to a beneficiary of the treaty. This has led to the question of whether the effect of MFN clauses is restricted to substantive standards or extends to the provisions on dispute settlement in these treaties. Put differently, is it possible to avoid the limitations attached to consent to arbitration in a treaty by relying on an MFN clause in the treaty if the respondent

22 *Generation Ukraine* v. *Ukraine*, Award, 16 September 2003, paras. 12.2, 12.3.
23 Article 1116 NAFTA.
24 Article 26(1) ECT.
25 *SGS* v. *Philipines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518; *Eureko* v. *Poland*, Partial Award, 19 August 2005; *Noble Ventures* v. *Romania*, Award, 12 October 2005; *MTD* v. *Chile*, Award, 25 May 2004. But see: *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406; *El Paso Energy Intl. Co.* v. *Argentina*, Decision on Jurisdiction, 27 April 2006.
26 See Article 1103 NAFTA.

State has entered into a treaty with a third State that contains a consent clause without the limitation? For instance, would a national of a country that has an old style BIT with China, providing for jurisdiction only for the amount of compensa-tion, be able to invoke an MFN clause to benefit from China's new BIT with Germany with its broad jurisdictional clause? Or even more radically, if the treaty con-taining the MFN clause does not offer consent to arbitration, is it possible to rely on consent to arbitration in a treaty of the respondent State with a third party?

Tribunals have used MFN clauses in a number of cases to overcome procedural obstacles where consent to jurisdiction had been given in the basic treaty.[27] But the issue whether an MFN clause can be used to establish jurisdiction which does not otherwise exist is an open question. I would tend to agree with Emmanuel Gaillard[28]: why not?

4. Shareholder Protection

Another area where big strides have been made is shareholder protection.[29] Investments often take place through the acquisition of shares in a company that has a nationality different from that of the investor.

The classical position was represented by *Barcelona Traction*[30]: only corporate rights would be protected and the corporation had to have the right nationality. Under this doctrine, a company established under the law of the host State would be disqualified, in principle, because it did not have the status of a foreign investor. A company established under the law of another State would be disqualified if that State did not have a BIT or another suitable treaty with the host State or because the company's home State was not a party to the ICSID Convention.

The issue is particularly acute where investments are made through companies incorporated in the host State. Many States require a locally incorporated company as a precondition for the investment. The local company would not as such qualify as a foreign investor and would hence be excluded from resorting to international arbitra-

27 *Maffezini* v. *Spain,* Decision on Jurisdiction, 25 January 2000, 5 ICSID Reports 396; *Siemens* v. *Argentina*, Decision on Jurisdiction, 3 August 2004, 44 ILM 138 (2005); *Gas Natural* v. *Argentina*, Decision on Jurisdiction, 17 June 2005. But see: *Salini* v. *Jordan*, Decision on Jurisdiction, 29 November 2004; *Plama* v. *Bulgaria*, Decision on Jurisdiction, 8 February 2005.

28 *Gaillard*, Establishing Jurisdiction Through a Most-Favored Nation Clause, New York Law Journal, June 2, 2005 p. 3.

29 See especially *Alexandrov*, The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*, 4 The Law and Practice of International Courts and Tribunals 19 (2005); *Schreuer*, Shareholder Protection in International Investment Law, Transnational Dispute Management, Vol. 2, Issue N°. 03, June 2005.

30 *Barcelona Traction, Light and Power Co.*, Ltd. (Belgium v. Spain), Judgement, 5 February 1970, ICJ Reports 1970, p. 4.

tion. This would have deprived a large proportion of foreign investment of international protection.

Contemporary treaty law offers a solution that gives independent standing to shareholders: most BITs include participation in a company in their definition of investment. In this way, the participation in the locally incorporated company becomes the investment. Even though the local company is unable to pursue the claim internationally, the foreign shareholder in the local company may pursue the claim in his own name. Put differently, the local company is not endowed with investor status but the participation therein, is seen as the investment. The shareholder may then pursue claims for adverse action by the host State against the local company that affects its value and profitability. Arbitral practice on this point is extensive and uniform.[31]

This is not a roundabout way of introducing a control theory to the nationality of corporations. Minority shareholders too have been accepted as claimants and have been granted protection under the respective treaties.[32] This practice has also been extended to indirect shareholding through an intermediate company.[33] The same technique has been employed where the affected company was incorporated not in the host State but in a third State.[34]

This shareholder protection extends not only to ownership in the shares but also to the assets of the company. Adverse action by the host State in violation of treaty

31 See *e.g.*: *Antoine Goetz et consorts* c. *République du Burundi,* Decision of 2 September 1998, 6 ICSID Reports 3; *Emilio Augustín Maffezini* v. *The Kingdom of Spain*, Decision on Jurisdiction, 25 January 2000, 5 ICSID Reports 396; *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 6 ICSID Reports 340; *Azurix Corp.* v. *Argentine Republic*, Decision on Jurisdiction, 8 December 2003, 43 ILM 259 (2004); *LG&E Energy Corp*. v. *Argentine Republic*, Decision on Jurisdiction, 30 April 2004; *Plama Consortium Ltd.* v. *Republic of Bulgaria*, Decision on Jurisdiction, 8 February 2005; *AMT* v. *Zaire*, Award, 21 February 1997, 36 ILM 1531 (1997), 5 ICSID Reports 11; *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil* v. *The Republic of Estonia***,** Award, 25 June 2001, 6 ICSID Reports 241; *CME Czech Republic B. V. (The Netherlands)* v. *The Czech Republic*, Partial Award, 13 September 2001; *Camuzzi* v. *Argentina*, Decision on Jurisdiction, 11 May 2005.

32 See *e.g.*: *AAPL* v. *Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 246; *LANCO* v. *Argentina*, Decision on Jurisdiction, 8 December 1998, 5 ICSID Reports 367; *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 6 ICSID Reports 340; *CMS Gas Transmission Company* v. *Republic of Argentina*, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003); *Champion Trading Co. and Ameritrade International Inc.* v. *Arab Republic of Egypt*, Decision on Jurisdiction, 21 October 2003; *GAMI Investments, Inc.* v. *Mexico*, Award, 15 November 2004; *LG&E Energy Corp.* v. *Argentine Republic*, Decision on Jurisdiction, 30 April 2004.

33 See *e.g.*: *Siemens A.G.* v. *Argentine Republic*, Decision on Jurisdiction, 3 August 2004, 44 ILM 138 (2005); *Enron Corp. and Ponderosa Assets, L.P.* v. *Argentine Republic*, Decision on Jurisdiction, 14 January 2004.

34 *Ronald S. Lauder* v. *The Czech Republic*, Award, 3 September 2001, 9 ICSID Reports 66; *Waste Management INC.* v. *United Mexican States*, Award, 30 April 2004, 43 ILM 967 (2004).

guarantees affecting the company's economic position gives rise to rights by the shareholders.[35]

This generous extension of procedural rights to shareholders is likely to lead to some interesting situations. Practical problems may arise where claims are pursued in parallel, especially by different shareholders. In addition, the affected company itself may pursue certain remedies while a group of its shareholders may pursue different ones. The situation becomes even more complex where indirect shareholding through intermediaries is combined with minority shareholding. In such a case shareholders and companies at different levels may pursue conflicting or competing litigation strategies that may be difficult to reconcile and coordinate.

III. Step Three: Backing Off?

Developments have not all been in favour of investors. The enthusiasm for investor protection has been dampened by the sometimes painful experience of States in losing cases. The pain is particularly acute if the damages awarded are high or if there are multiple cases against the State in question. For some countries the mere fact of being sued is already a cause of alarm and a reason to think about ways to limit the access of investors to international arbitration.

Signs of retreat from investment arbitration have manifested themselves in a number of ways. Here are a few examples.

1. The Revival of Domestic Remedies

One is the revival of domestic remedies.[36] International investment arbitration dispenses with the traditional requirement to exhaust local remedies, at least in principle. Article 26 of the ICSID Convention specifically does away with this traditional requirement "unless otherwise stated". Arbitral practice confirms that the exhaustion of local remedies is not required in contemporary investment arbitration.[37]

But States have attempted to counteract international arbitration by inserting forum selection clauses in investment contracts. Under these clauses disputes arising in the context of the contract are to be taken to national courts or tribunals. When the investors instituted international arbitration on the basis of a BIT, the host States

35 *GAMI Investments, Inc.* v. *Mexico*, Award, 15 November 2004.

36 Generally see *Schreuer*, Calvo's Grandchildren : The Return of Local Remedies in Investment Arbitration, 4 The Law and Practice of International Courts and Tribunals, 1-17 (2005).

37 *Lanco* v. *Argentina*, Decision on Jurisdiction, 8 December 1998, para. 39, 40 ILM 457, 469/70 (2001); *Generation Ukraine* v. *Ukraine*, Award, 16 September 2003, paras. 13.1–13.6; *Yaung Chi Oo* v. *Myanmar*, Award, 31 March 2003, para. 40, 42 ILM 540, 547/48 (2003); *Loewen* v. *United States*, Award, 26 June 2003, paras. 142 et seq., 42 ILM 811 (2003).

would object contending that the contractual forum selection clause, pointing to domestic litigation, constituted a waiver of international arbitration.

Tribunals have reacted by adopting the distinction between treaty claims and contract claims. They have held consistently that the contractual clauses pointing to domestic courts did not deprive them of their jurisdiction to hear claims for violations of international law, especially BIT claims.[38]

The distinction between contract claims and treaty claims has become a standard feature of recent investment arbitrations. The Respondent's objection, that the case only involves contract claims and the Claimant's insistence that treaty rights are involved, are routine features of many recent cases. As it turned out, the distinction between treaty claims and contract claims is not always easy. A particular course of action by the host State may well constitute a breach of contract and a violation of international law. The two categories are not mutually exclusive. Rather, two different standards have to be applied to determine whether one or the other or both have been violated. The *ad hoc* Committee in *Vivendi*[39]said:

"... whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract ..."[40]

The situation is made even more complex by the fact that some treaties offer jurisdiction for any investment dispute, which probably includes contract claims. Also umbrella clauses will convert contract breaches into treaty breaches.[41]

The problem with the separate treatment of contract claims and treaty claims is less a theoretical than a practical one. It leads to situations where the claimant is

38 See e.g. *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic*, Award, 21 November 2000, 16 ICSID Review – FILJ 643 (2001); 5 ICSID Reports 296; 40 ILM 426 (2001); *Compañía de Aguas del Aconquija, S. A. & Vivendi Universal (formerly Compagnie Générale des Eaux)* v. *Argentine Republic*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 41 ILM 1135 (2002); *Salini Costruttori SpA et Italstrade SpA* c/ *Royaume du Maroc*, Decision on Jurisdiction, 23 July 2001, Journal de Droit International 196 (2002), 6 ICSID Reports 400, 42 ILM 609 (2003); *CMS* v. *Argentina*, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003); *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1289 (2003); *Azurix* v. *Argentina*, Decision on Jurisdiction, 8 December 2003; *Enron* v. *Argentina*, Decision on Jurisdiction, 14 January 2004; *SGS* v. *Philippines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518; *Siemens* v. *Argentina*, Decision on Jurisdiction, 3 August 2004. For a broader discussion see *Schreuer*, Investment Treaty Arbitration and Jurisdiction over Contract Claims - the *Vivendi I* Case Considered, in *Weiler*, ed., International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law 281-323 (2005).

39 *Compañía de Aguas del Aconquija, S. A. & Vivendi Universal (formerly Compagnie Générale des Eaux)* v. *Argentine Republic*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 41 ILM 1135 (2002).

40 At para. 96.

41 See above at Fn 25.

compelled to pursue part of its claim through national and another part through international procedures. This has undesirable results. The need to dissect cases into contract claims and treaty claims to be dealt with by separate fora requires claim splitting and has the potential of leading to parallel proceedings. This is uneconomical and contrary to the goal of reaching final and comprehensive resolutions of disputes.

Even worse, the separation of types of claims arising from the same set of facts can lead to a situation where a host State, threatened by a treaty claim before an international tribunal, will start domestic proceedings before a local court or domestic tribunal which it can control in order to counteract and frustrate the international proceedings. In this way, the host State can exert pressure on the investor to settle or withdraw the treaty claim. Alternatively, the host State can use the domestic proceedings to recoup the money awarded in the international award through an action for breach of contract against the investor. Put differently, allowing the host State to pursue contract claims from the same dispute in its own domestic forum can undermine the procedural protection granted to the foreign investor in the BIT.

In some cases tribunals have reintroduced domestic remedies in a different way. They have at times indicated that a violation of a treaty standard occurs only once some redress has been sought and denied through proceedings in domestic courts. For instance, a tribunal found that a de facto expropriation could not be assumed in the absence of a reasonable effort to obtain correction in the domestic courts.[42]

Similarly, another tribunal found that the availability of local remedies was relevant to whether the host State had violated the treaty standard of fair and equitable treatment.[43] It is not difficult to see that the rationale in these cases can be developed into something that reintroduces the local remedies rule through the back door.

2. Restricting Substantive Standards

In another attempt to stem the tide of investment claims States have attempted to limit the meaning of the substantive standards granted to investors.

One such attempt concerns the standard of fair and equitable treatment (FET) which is contained in most treaties. This standard has created a considerable amount of case law and is nowadays invoked in almost every case. Its somewhat open ended and flexible nature, has led to attempts to restrict its meaning.

Article 1105(1) of the NAFTA providing for FET has been the subject of an official interpretation by the NAFTA Free Trade Commission (FTC), a body composed of representatives of the three States Parties with the power to adopt binding inter-

42 *Generation Ukraine, Inc*. v. *Ukraine*, Award, 16 September 2003, para. 20.30. See also *Lauder* v. *Czech Republic*, Award, 3 September 2001, para. 204, 9 ICSID Reports 66.

43 *Waste Management, Inc*. v. *United Mexican States*, Award, 30 April 2004, para. 116.

pretations.[44] The FTC interpretation of July 2001 states that Article 1105(1) reflects the customary international law minimum standard and does not require treatment beyond what is required by customary international law.[45] NAFTA tribunals have accepted the FTC interpretation.[46]

The recent BITs of the US and Canada incorporate this approach by stating that FET does not require treatment beyond what is required by customary IL.[47]

Tribunals not operating under such restrictive interpretations have not adopted a dogmatic position on whether the fair and equitable treatment standard contained in BITs is an autonomous standard or merely reflects customary international law.[48] Rather, they have interpreted the relevant provisions in BITs autonomously as a matter of treaty interpretation.[49]

Professor *Dolzer* has pointed out that the attempt to contain the meaning of FET by equating it with customary IL may have exactly the opposite effect. The specific meaning that tribunals have given to fair and equitable treatment may be projected into customary international law. The consequence is that investors may in the future invoke the detailed case law on fair and equitable treatment as part of customary international law even in situations that are not subject to a treaty provision containing that standard.

Another area where there have been recent attempts to dampen the enthusiasm of investors to bring claims against host States has been expropriation. There is a lively debate surrounding the State's right to regulate in the public interest. Of course it is not per se unreasonable for States to insist on their right to regulate. On the other hand, investors predictably insist on the protection of their assets even if the State purports to act in the public interest.

44 Article 1131 (2) NAFTA.

45 FTC Note of Interpretation of 31 July 2001.

46 See *e.g.*: *Mondev International Ltd.* v. *United States of America*, Award, 11 October 2002, 6 ICSID Reports 192, paras. 100 *et seq.*; *United Parcel Service of America, Inc.* v. *Canada*, Award, 22 November 2002, 7 ICSID Reports 288, para. 97; *ADF Group, Inc.* v. *United States of America*, Award, 9 January 2003, 6 ICSID Reports 470, paras. 175–178; *Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America*, Award, 26 June 2003, 7 ICSID Reports 442, paras. 124–128; *Waste Management, Inc.* v. *United Mexican States*, Award, 30 April 2004, paras. 90–91. See also *United Mexican States* v. *Metalclad Corp*., Judgment, Supreme Court of British Columbia, 2 May 2001, 5 ICSID Reports 236, paras. 61–65.

47 US Model BIT 2004, Article 5(1)(2).

48 See *CMS Gas Transmission Company* v. *Argentina,* Award, 12 May 2005 at paras. 282-284 where the Tribunal found that the question whether the standard of fair and equitable treatment was identical with customary international law was not relevant in the case before it since "the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under customary law." At para. 284.

49 See e.g. *Técnicas Medioambientales Tecmed S. A.* v. *The United Mexican States*, Award, 29 May 2003, 43 ILM 133 (2004), paras. 155 and 156; *MTD* v. *Republic of Chile*, Award, 25 May 2004, paras. 110–112; *Occidental Exploration and Production Co.* v. *Ecuador*, Award, 1 July 2004, paras 188–190.

Under classical IL and most treaty provisions dealing with expropriation, the existence of a public purpose is a requirement for the legality of an expropriation together with non-discrimination and appropriate compensation. It would seem to follow that a legitimate public purpose cannot be the basis of an argument that no expropriation has occurred. Rather, the existence of a public purpose is a requirement for the expropriation's legality in addition to compensation.

Recent treaties, especially of the United States state that except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations.[50]

Judge *Schwebel* has referred to these Developments as a "Regressive Development of International Law"[51]. Indeed there is a danger that immunizing interferences with investments on account of their public purpose may seriously undermine the protection against indirect expropriations as we know it.

These ideas have already borne fruit in arbitral practice. In *Methanex* v *US*[52] the Tribunal said quite bluntly that a measure that is taken for a public purpose, is non-discriminatory and is accomplished with due process is not an expropriation but a lawful regulation and hence does not require compensation.[53] This position was subsequently repeated and expanded in *Saluka* v. *Czech Republic*.[54]

There are two kinds of problems with that approach. One is a question of logic. The other is a matter of policy. As a matter of logic, if a lawful expropriation requires a public purpose and full compensation it seems difficult to say that a legitimate public purpose means there is no expropriation but just regulation and therefore no compensation needs to be paid.

The policy issue is perhaps more serious. Once it is accepted that regulatory action for a public purpose by definition is not an expropriation, one is on a very slippery slope. It will not be difficult to find a legitimate public purpose for most measures affecting foreign investors. It would then be for the investor to bear the economic consequences of such measures even if they radically affect the investment. Taken to its logical conclusion this could well spell the end of protection of foreign-owned property as we know it.

50 US Model BIT 2004, Annex B, Para. 4 (b).

51 *Schwebel*, The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law, Transnational Dispute Management, Vol. 3, N° 2, April 2006.

52 *Methanex* v. *United States*, Award, 3 August 2005.

53 At Part IV, Chapter D, paras. 7, 14.

54 *Saluka* v. *The Czech Republic*, Partial Award, 17 March 2006 at paras. 254, 255, 262, 276.

3. Tango Argentino: Some Radical Proposals

Among the States that are unhappy about investment arbitration, Argentina is surely the unhappiest. It has several dozen cases pending against it and there are a number of adverse decisions already although most of these concern jurisdictional ques-tions and are hence preliminary. The aggregate amount in dispute under these cases is staggering and goes into the billions.

Argentina, is considering drastic action. There are a number of proposed bills that foresee:

- denouncing all BITs that foresee international investment arbitration,
- establishing that claims against Argentina may only be brought to Argentinean courts,
- declaring that international arbitral awards are unenforceable unless they have been reviewed by local courts.

These proposals are obviously contrary to Argentina's treaty obligations under the ICSID Convention and under the applicable BITs. From a legal perspective such threats may not carry much weight and are easily dismissed. Nevertheless signs of States becoming weary with the system of investment arbitration should not be taken lightly. Other countries might follow suit and take joint action once they realize that they continue to be on the losing side of investment arbitrations. After all, it is the States that ultimately control the system.

So is investor-State arbitration in danger? The answer is probably: not yet but we should not necessarily take it for granted. There may well be further curtailments or even calls to replace the current system by a State v. State system.

D. Finale: It Takes Two to Tango
The Complementary Interests of Investors and Host States

It is appropriate to keep in mind and to remind States that investment arbitration is not a one-sided system that works all in favour of investors. Investment protection is also in the longer term interest of host States. It is no coincidence that the ICSID Convention was conceived in the framework of the World Bank and that the first sentence of its Preamble refers to the need for international cooperation for economic development and the role of private international investment therein.

Investment arbitration carries more than one advantage to host States. The more obvious advantage is a country's improved investment climate through the possibility of international arbitration. The possibility of going to arbitration is an important element of the legal security required for an investment decision. In other words, by offering arbitration the host State creates an important incentive to foreign investment.

The Tribunal in *Amco* v. *Indonesia*[55] pointed out that:

"...to protect investments is to protect the general interest of development and of developing countries."[56]

In addition, by consenting to ICSID arbitration the host State protects itself against other forms of foreign or international litigation. In particular, a major advantage of ICSID arbitration is that the host State effectively shields itself against diplomatic protection by the State of the investor's nationality.

Before investors received the right to pursue claims on their own behalf on the international level, the standard practice was for their home States to act on their behalf. This method carried political disadvantages for both States. It often created friction between the States concerned and cast a shadow over their relations. Not surprisingly, developing countries do not like being leaned upon by powerful industrialised States. In an investment dispute the limited inconvenience of having to defend a case before an international tribunal may be vastly preferable to the alternative of feeling the pressure of the United States, of Germany or of the European Commission.

Like most successful human endeavours investment arbitration serves the interests of all concerned. It is important to make sure that the system keeps its proper balance but also that everyone concerned is aware of this mutual interest.

55 *Amco* v. *Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 389.
56 At para. 23. See also Award, 20 November 1984, 1 ICSID Reports 413, at para. 249.

"Fair and Equitable Treatment" as an Embodiment of the Rule of Law

Stephan Schill[*]

A. Introduction

After forty years of ICSID arbitration it is not only time to take stock of past developments in international investment arbitration. Given above all the widespread criticism investor-state dispute settlement is facing in regard of its restrictive effect on host state law- and policy-making, it is also time to develop more conceptual frameworks with respect to the substantive law contained in international investment treaties. Among other factors, the criticism seems to stem to a large extent from the considerable vagueness of many standard guarantees in international investment treaties[1] and the perception that their interpretation by investment tribunals is unpredictable and comprises the risk of inconsistent or even contradictory interpretation.[2]

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1 See *Soloway*, NAFTA's Chapter 11: The Challenge of Private Party Participation, 16 J. Int'l Arb. 1, 3 (1999) (arguing that the "lack of clarity in Chapter 11 prevents the establishment of a secure and stable framework for investments"); *Ferguson*, California's MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretative Note on Article 1110 of NAFTA, 11 Colo. J. Int'l Envt'l L. & Pol'y 499, 503 (2000) (noting that the "vague language" of NAFTA allows for an "abuse" of investor-state dispute resolution); *Beauvais*, Regulatory Expropriations Under NAFTA: Emerging Principles and Lingering Doubts, 10 N.Y.U. Envt'l L. J. 245, 257 *et seq.* (2001-2002); *Poirier*, The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist, 33 Environmental Law 851, 902 *et seq.* (2003); *Been/Beauvais*, The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine, 78 N.Y.U. L. Rev. 30, 125 *et seq.* (2003) (all noting the vagueness of the expropriation standard under international law); *Porterfield*, An International Common Law of Investor Rights?, 27 U. Pa. J. Int'l Econ. L. 79 (2006) (arguing that fair and equitable treatment due to its vagueness cannot constitute a legitimate norm of international law); *Garcia*, All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration, 16 Fla. J. Int'l L. 301, 350 (2004) (referring to "the vague and unbounded notions of fair and equitable treatment and full protection and security").

2 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1558 *et seq.* (2005).

In this context, commentators frequently allude to a "legitimacy crisis" in investment arbitration.[3]

While initially the protection of foreign investors against indirect expropriations has been the focus of much political and academic debate,[4] more recently another key guarantee of international investment treaties is coming to the fore in the ongoing struggle over the appropriate scope of international investment protection: the standard of fair and equitable treatment. Being attested to have "the potential to reach further into the traditional 'domaine réservé' of the host state than any one of the other rules of [investment] treaties",[5] fair and equitable treatment is emerging as one of the core concepts governing the relationship between foreign investors and host states in international investment law. The standard appears prominently in almost all of the approximately 2400 bilateral investment treaties (BITs) as well as regional and multilateral investment treaties, such as Art. 1105(1) of the North American Free Trade Agreement (NAFTA) and Art. 10(1) of the Energy Charter Treaty (ECT), prior to that figured in the Friendship, Commerce and Navigation Treaties the United States concluded with various countries and played a role in all multilateral projects relating to the protection of foreign investment.[6]

Despite its textual presence in various international legal instruments over a period of over 60 years, fair and equitable treatment has for a long time received surprisingly little attention in academic literature and in the practice of international courts and tribunals. Over the past five years, however, fair and equitable treatment has emerged as a central element on the grounds of which host states are increasingly often ordered to pay damages to foreign investors in disputes before international

3 *Brower*, A Crisis of Legitimacy, Nat'l L. J., Oct. 7, 2002; *Afilalo*, Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis, 17 Geo. Int'l Envt'l L. Rev. 51 (2004); *Franck* (supra note 2), 73 Fordham L. Rev. 1521 (2005).

4 *Dolzer*, Indirect Expropriation: New Developments?, 11 N.Y.U. Envt'l L. J. 64 (2002-2003); *Been/Beauvais* (supra note 1), 78 N.Y.U. L. Rev. 30 (2003); *Brunetti*, Indirect Expropriation in International Law, 5 Int'l L. FORUM du droit int. 150 (2003); *Dolzer/Bloch*, Indirect Expropriation: Conceptual Realignments?, 5 Int'l L. FORUM du droit int. 155 (2003); *Fortier/Drymer*, Indirect Expropriation in the Law of International Investment: I know It When I See It, or Caveat Investor, 19 ICSID Rev. — Foreign Inv. L. J. 293 (2004); *Yannaca-Small*, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law, OECD Working Papers on International Investment, Number 2004/4, available at http://www.oecd.org/dataoecd/22/54/33776546.pdf (all websites visited last on July 11, 2006); *Kunoy*, Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration, 6 J. World Inv. & Trade 467 (2005); *Newcombe*, The Boundaries of Regulatory Expropriation, 20 ICSID Rev. – Foreign Inv. L. J. 1 (2005).

5 *Dolzer*, The Impact of International Investment Treaties on Domestic Administrative Law, 37 N.Y.U. J. Int'l L. & Pol. 953, 964 (2005).

6 See on the history of the fair and equitable treatment standard *Vasciannie*, The Fair and Equitable Treatment Standard in International Investment Law and Practice, 70 Brit. Yb. Int'l Law 99 (1999); *Yannaca-Small*, Fair and Equitable Treatment Standard in International Investment Law, OECD Working Papers on International Investment, Number 2004/3, p. 3 *et seq.*, available at http://www.oecd.org/dataoecd/22/53/33776498.pdf.

arbitral tribunals. Yet, the frequency with which it is invoked by foreign investors and applied as a basis for state responsibility by arbitral tribunals contrasts with an astonishingly fundamental lack of conceptual understanding about the principle's normative content. Given that fair and equitable treatment undoubtedly constitutes a legal standard, not an empowerment of arbitral tribunals to render decisions *ex aequo et bono*,[7] the tribunals are faced with the task to enrich this admittedly vague standard with concrete normative content in order to apply it to the factual circumstances submitted to them.

Although the language of the various investment treaties is not uniform, varying above all between a plain prescription of fair and equitable treatment and a combination of the standard with an explicit reference to international law or the customary international minimum standard,[8] it is questionable whether substantial differences result from the different framing of the standard with a view to the actual practice of investment tribunals. This has become apparent in particular in the NAFTA context where Art. 1105(1) has to be interpreted – pursuant to a binding interpretation by NAFTA's Free Trade Commission under Art. 1131(2) – in accordance with customary international law.[9] Two factors, in particular, level possible differences between treaty law and custom in this context. First, some tribunals held that the inclusion of fair and equitable treatment in the vast web of international investment agreements has transformed the standard itself into customary international law.[10] Secondly, even absent such an explicit transformation, other tribunals interpret the international minimum standard as an evolutionary concept that has evolved since the days of traditional international law concerning the treatment of aliens.[11] This evolution-

7 See *Yannaca-Small* (supra note 6), p. 40; *Schreuer*, Fair and Equitable Treatment in Arbitral Practice, 6 J. World Inv. & Trade 357, 365 (2005); see also *Case Concerning Oil Platforms (Islamic Republic of Iran v. United States of America) – Preliminary Objection*, Judgment of Dec. 12, 1996, ICJ Reports 1996, 803 *et seq.*, Separate Opinion by Judge *Higgins*, par. 39.

8 See *Dolzer*, Fair and Equitable Treatment: A Key Standard in Investment Treaties, 39 Int'l Law. 87, 90 (2005) (explaining that the plain approach prevails in the treaty practice of Germany, the Netherlands, Sweden and Switzerland, whereas the BITs of France, the United Kingdom and the United States generally make reference to international law). See also *UNCTAD*, *Fair and Equitable Treatment*, p. 10 *et seq.* (1999), available at http://www.unctad.org/en/docs/psiteiitd11v3.en.pdf.

9 *NAFTA Free Trade Commission*, *Notes of Interpretation of Certain Chapter 11 Provisions*, 31 July 2001, available at http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

10 See for example *Pope & Talbot v. Canada*, UNCITRAL/NAFTA, Award in Respect of Damages of May 31, 2002, par. 62; similarly *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award of Oct. 11, 2002, par. 125 (all investment awards are, unless explicitly stated otherwise, available via http://www.investmenclaims.com); see also *Hindelang*, Bilateral Investment Treaties, Custom and a Healthy Investment Climate – The Question of Whether BITs Influence Customary International Law Revisited, 5 J. World Inv. & Trade 789 (2004).

11 See *Pope & Talbot* (supra note 10), par. 58 *et seq.*; *Mondev v. United States* (supra note 10), par. 125; *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Final Award of Jan. 9, 2003, par. 179; see also *Choudhury*, Evolution or Devolution? – Defining Fair and Equitable Treatment in International Investment Law, 6 J. World Inv. & Trade 297 (2005).

ary interpretation also levels differences between treaty law and custom concerning the fair and equitable treatment standard.

This paper attempts to contribute to the on-going debate on rule- and decision-making of investment tribunals with a specific view to the tribunals' construction and application of fair and equitable treatment. The task in the context of this paper does, however, not consist in exhaustively describing the facts of each case and the conclusions drawn by arbitral tribunals; the arbitral jurisprudence on fair and equitable treatment has been accurately and extensively discussed in a number of scholarly contributions.[12] Instead, the paper focuses on outlining the elements arbitral tribunals attribute to fair and equitable treatment in a more conceptual way and attempts to provide a general framework of analysis for the standard's application and interpretation.

In Part II, the paper takes a critical look at the way arbitral tribunals interpret and apply fair and equitable treatment and points to some shortcomings in the arbitral jurisprudence resulting mainly from the standard's considerable vagueness. Part III subsequently aims at clarifying the normative content of fair and equitable treatment and outlines a methodology for the application of fair and equitable treatment to the circumstances of a case submitted to arbitration. This should promote predictability in and uniformity of the standard's interpretation and thus its acceptance by states and investors.

The paper shows how international tribunals have developed certain sub-elements of fair and equitable treatment that appear in recurrent fashion in arbitral jurisprudence and argues that these elements can be understood as and united under the concept of the rule of law (*Rechtsstaat* in the German, *état de droit* in the French tradition). The underlying assumption of such an approach is that the fair and equitable treatment standard has an independent and genuine normative content that is different from other rights granted in international investment treaties. Understanding fair and equitable treatment in such a fashion attributes to the standard a quasi-constitutional function that serves as a yardstick for the exercise of the host states' administrative, judicial or legislative activity vis-à-vis foreign investors. In this perspective, the arbitral jurisprudence does not appear as a fragmented and disordered aggregate of awards but as an expression of the continuous emergence of a global regime that governs foreign investment and the conduct of host states relating to it. Conceptualizing fair and equitable treatment as an embodiment of the rule of law mainly relies on a comparative public law approach that takes a cross-view of the restrictions of governmental activity in domestic legal systems that embrace the concept of the rule of law.

Conversely, the appropriate methodology for concretizing fair and equitable treatment the paper suggests, consists in a comparative method that attempts to ex-

12 See for recent attempts to sum up the jurisprudence *Yannaca-Small* (supra note 6), p. 13 *et seq.*; *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297 (2005); *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357 (2005); *Dolzer* (supra note 8), 39 Int'l Law. 87 (2005).

tract general principles from domestic legal systems and other international legal regimes that embrace an institutional design prescribing rule of law standards for the exercise of governmental power in administrative and judicial proceedings and legislation. At the same time, a comparative approach to fair and equitable treatment illustrates the tension between the rule of law as a legal value and competing public interests that require a proportionate balance. It underscores that fair and equitable treatment cannot be understood as an absolute guarantee but rather as a principle that allows for a balance between investment protection and the host state's public interest.

This understanding of fair and equitable treatment can, however, not only be used as a conceptual explanation of the bulk of the arbitral jurisprudence, but can be grounded in the normative framework contained in international investment treaties, above all the treaties' object and purpose. Part IV therefore provides an analysis of the economics of international investment treaties and shows the positive effects the adoption of the concept of the rule of law has on the behavior of foreign investors, thus promoting foreign investment and economic growth in host countries.

B. Shortcomings in Arbitral Practice Relating to Fair and Equitable Treatment

Arbitral tribunals seem generally ill-equipped in tackling the interpretative conundrum posed by the vagueness of the fair and equitable treatment standard. Tribunals do not only regularly criticize that the standard is not further defined and clarified in investment agreements,[13] they have also not achieved to develop a uniform methodology in order to determine whether specific host state conduct violates fair and equitable treatment.[14] The main reason for this is that traditional interpretative approaches applying Articles 31 and 32 of the Vienna Convention on the Law of Treaties,[15] either directly or as an expression of the customary international law of treaty

13 See *Alex Genin, Eastern Credit Limited, Inc. and A. S. Baltoil v. The Republic of Estonia*, ICSID Case No ARB/99/2, Award of June 25, 2001, par. 367: "the exact content of this standard is not clear"; *Consortium R.F.C.C. v. Royaume du Maroc*, ICSID Case No. ARB/00/6, Sentence Arbitrale of Dec. 22, 2003, par. 51: "Il n'existe pas de définition précise du traitement just et équitable dans le droit des traités"; *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award of Sept. 2, 2001, par. 292: "[T]here is no further definition of the notion of fair and equitable treatment in the Treaty."; *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award of May 12, 2005, par. 273: "The Treaty, like most bilateral investment treaties, does not define the standard of fair and equitable treatment."

14 Criticizing the lack of a uniform methodology, for example, *Kantor*, Fair and Equitable Treatment: Echoes of FDR's Court-Packing Plan in the International Law Approach Towards Regulatory Expropriation, 5 The Law and Practice of International Courts and Tribunals 231 (2006).

15 U.N. Doc. A/CONF.39/27 (1969), 1155 U.N.T.S. 331.

interpretation,[16] are hardly able to clarify the meaning of fair and equitable treatment. The vagueness of the standard goes beyond the commonplace assertions in legal theory that law is inherently vague and indeterminate when it comes to the application of abstract standards to concrete cases. Vagueness and indeterminacy of fair and equitable treatment are not a matter of the penumbra of a rule in the *Hartian* sense or the edges of the rule's frame in the *Kelsenian* sense, but concern the very core of the provision. It does not have a consolidated and conventional core meaning that can easily be applied. Apart from consensus on the fact that fair and equit-able treatment constitutes a standard that is independent from the domestic legal order and does not require actions in bad faith by host states,[17] it is hardly substantiated by state practice or elucidated by *travaux preparatoires* and difficult to narrow down by traditional means of interpretation.

An interpretation of the ordinary meaning may replace the terms "fair and equitable" with similarly vague and empty phrases such as "just", "even-handed", "unbiased" or "legitimate",[18] but does not succeed in clarifying its normative content.[19] In particular, the semantics of fair and equitable treatment do not clarify as against which standard "fairness and equitableness" has to be measured. It could equally refer to notions of equality or substantive justice, or to less grand notions of procedural due process.

Likewise, a plain teleological interpretation hardly provides more specific meaning even if the purpose of international investment treaties points to the protection and promotion of foreign investment and the deepening of the mutual economic relations between the contracting states.[20] Although this narrows down the possible understandings of fair and equitable treatment to an economic framework, a purposive interpretation does not enable tribunals to directly translate the broad language into specific guarantees for foreign investors in the sense of hard and fast rules. In particular, it is difficult to foresee and estimate whether a specific interpretation of an international investment treaty will actually encourage investment flows or whether, on the contrary, an interpretation that may be too onerous for host states

16 See only *Case Concerning the Territorial Dispute (Libyan Arab Jamahiriya v. Chad)*, Judgment of Feb. 13, 1994, ICJ Reports 1994, 21, par. 41; *Case Concerning Oil Platforms (Islamic Republic of Iran v. United States of America)*, Judgment of Dec. 12, 1996, ICJ Reports 1996, 803, par. 23; *Case Concerning Kasikili/Sedudu Island (Botswana v. Namibia)*, Judgment of Dec. 13, 1999, ICJ Reports 1999, 1045 par. 18.

17 Concerning the independence of fair and equitable treatment from domestic law *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005); on the independence from bad faith *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 384 *et seq*. (2005).

18 *Cf. MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award of May 25, 2004, par. 113.

19 It rather confirms that a terminological approach does not succeed in substantiating and clarifying what fair and equitable refers to. In this sense *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award of Mar. 17, 2006, par. 297; differently *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005).

20 See on the object and purpose of investment treaties and the statements contained in their preambles *Dolzer/Stevens*, Bilateral Investment Treaties, p. 11 *et seq.*, 20 *et seq.* (1995).

will have the effect of chilling the investment climate due to host states admitting less foreign investment.[21]

The traditional methods of treaty interpretation therefore prove to be relatively ineffective in clarifying the meaning of fair and equitable treatment. Understandably, investment tribunals do not follow a uniform methodology.[22] Some tribunals follow an approach that extensively describes the facts of a case and simply characterizes them as a violation of fair and equitable treatment.[23] The problem with this approach is that it does not elucidate the normative content of fair and equitable treatment and leaves the legal reasoning underlying the decision in the obscure. Other tribunals simply posit an abstract standard as part of fair and equitable treatment and subsequently subsume the facts of the case under this standard.[24] While this is closer to the traditional legal syllogism, the tribunals nevertheless fail to properly justify how they ground these abstract standards in fair and equitable treatment. Finally, various tribunals apply fair and equitable treatment with a strong reference to prior arbitral jurisprudence.[25] This approach is critical in two respects. First, treating arbitral decisions as precedent in international law is problematic;[26] secondly, the awards face the criticism that earlier decisions have themselves applied a problematic methodology in terms of failing to grasp the normative content of fair and equitable treatment.

By failing to establish a clear normative, i. e. prescriptive, content of fair and equitable treatment, arbitral tribunals run the risk of facing the reproach that they handle the standard as a malleable tool of *ex post facto* control of host states' meas-

21 Accordingly, the Tribunal in *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award of Oct. 12, 2005, par. 52 warned that a teleological interpretation should not simply lead to an interpretation of bilateral investment treaties *in dubio pro investore*: "While it is not permissible, as is too often done regarding BITs, to interpret clauses exclusively in favour of investors, here such an interpretation is justified." (emphasis added).

22 See *Dolzer* (supra note 8), 39 Int'l Law. 87, 93 *et seq.* (2005) (discerning the three lines of reasoning subsequently addressed).

23 See, for example, *Mondev v. United States* (supra note 10), par. 118, stressing that "[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case".

24 See, for example, *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL/NAFTA, Partial Award of Nov. 13, 2000, par. 134.

25 See for example *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, par. 89 *et seq.*

26 Under general international law no doctrine of *stare decisis* exists, see Articles. 38(1)(d) and 59 of the Statute of the International Court of Justice; see also *Verdross/Simma*, Universelles Völkerrecht, p. 397 *et seq.* (3rd ed. 1984). This general observation also holds true in the investment arbitration context. Explicitly in this sense Art. 1136(1) NAFTA: "An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case." See also *Schreuer*, The ICSID Convention: A Commentary, Art. 53 par. 15 (2001) (noting that in the preparatory works for the ICSID Convention nothing implies the applicability of a *stare decisis* rule). Art. 53(1) ICSID-Convention that provides that "[t]he award shall be binding on the parties […]" can therefore be read as "binding *only* on the parties".

ures based on the arbitrators' personal conviction and understanding about what is fair and equitable. The assumption that personal convictions, instead of prescriptive legal standards, play a major role in applying fair and equitable treatment is nourished by the frequent reference to treatment that "shocks, or at least surprises, a sense of juridical propriety"[27] as a yardstick for the standard's application.[28]

Similarly, legal scholarship has not provided much conceptual guidance.[29] Like arbitral tribunals, commentators have not developed a definition or a methodological tool for concretizing fair and equitable treatment. Above all, they have not attempted to unite the vast jurisprudence under a comprehensive concept in order to give a fuller normative explanation of the standard's content. Mostly, they concede that no agreement on the exact meaning of the principle exists[30] and largely confine themselves to describing the existing case law in order to extract contextual elements of fair and equitable treatment[31] or attribute to it the function of a gap-filling device for judging host state conduct that cannot be subsumed under other, possibly more precise, investment treaty guarantees.[32] Some commentators therefore suggest that fair and equitable treatment constitutes "an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules ne-

27 See for example *Técnicas Medioambientales Tecmed S. A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003, par. 154 (quoting the decision of the International Court of Justice in *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment of July 20, 1989, ICJ Reports 1989, p. 15, par. 128). See for a criticism of the ICJ's test for arbitrariness in the *ELSI* case *Hamrock*, The ELSI Case: Toward an International Definition of "Arbitrary" Conduct, 27 Tex. Int'l L. J. 837, 849 *et seq.* (1992) (highlighting the prevalence of subjective elements in the Court's test).

28 See *UNCTAD* (supra note 8), p. 10 (noting the "inherently subjective" trait of the concepts of fairness and equitableness); see also *Yannaca-Small* (supra note 6), p. 2 *et seq.* (mentioning the concern of "a number of governments […] that, the less guidance is provided for arbitrators, the more discretion is involved and the closer the process resembles decisions *ex aequo et bono, i.e* [sic] based on the arbitrators' notions of 'fairness'and 'equity'.").

29 See also *Thomas*, Reflections on Art. 1105 NAFTA: History, State Practice and the Influence of Commentators, 17 ICSID Rev. – Foreign Inv. L. J. 21, 51 *et seq.* (2002). (warning to attach too much weight to the opinions of commentators).

30 *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005) (noting that "a review of some attempts at defining the standard may invite such thinking inasmuch as the approach is so general in nature that the clause may appear to amount to a catch-all provision which may embrace a very broad number of governmental acts"); *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 364 (2005); *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297, 298 (2005).

31 *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 364 *et seq.* (2005) (stressing the specific fact situations considered as a violation of fair and equitable treatment); *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297, 316 *et seq.* (2005) (providing a working definition of fair and equitable treatment that relies on the acceptance of several sub-elements of the standard in arbitral jurisprudence); see also *Thomas* (supra note 29), 17 ICSID Rev. – Foreign Inv. L. J. 21, 59 *et seq.* (2002); *Sornarajah*, The International Law of Foreign Investment, p. 332 *et seq.* (2nd ed. 2004).

32 *Dolzer* (supra note 8), 39 Int'l Law. 87, 90 (2005). Similarly *Mann*, British Treaties for the Promotion and Protection of Investments, 52 Brit. Yb. Int'l L. 241, 243 *et seq.* (1981) (understanding fair and equitable as an "overriding duty").

cessary to achieve the treaty's object and purpose in particular disputes".[33] Similarly, other commentators support the view that the interpretative problems posed by the principle's vagueness should be solved by simply letting tribunals do the work in developing more precise elements of fair and equitable treatment.[34]

It is, however, questionable whether states intended such a broad delegation of powers to international tribunals.[35] In addition, shifting the responsibility of concretizing the meaning of fair and equitable treatment to arbitral tribunals is problematic. It does not only fail to meet the need for further guidance regularly uttered by some tribunals themselves. More importantly, it is unsatisfactory from the perspective of host states that need to evaluate the way they exercise public authority without having to pay damages for the violation of investment treaties.[36] Likewise, it is unsatisfactory from the perspective of foreign investors who desire a stable and predictable investment climate and need to know beforehand against which political risks and government interferences they are protected by the respective investment treaty. Unpredictable, or worse arbitrary, outcomes of arbitration proceedings will not only dissatisfy the parties involved, but may overall chill the efficiency of investment arbitration and the promotion of foreign investment.

A missing conceptual understanding of fair and equitable treatment may also lead to inconsistent decisions in the field of investment protection, possibly lessening the stability and predictability necessary for foreign investment and fostering the fragmentation of international investment law. A theoretic approach to the normative content of fair and equitable treatment may, therefore, not only clarify the conceptual foundations of the standard but is also crucial in order to generate a sustainable understanding of the rights and obligations of investors and host states that are critical to the very basis of international investment protection. With respect to fair and equitable treatment a clearer delineation between investors' rights and state sovereignty is thus needed.

33 *Brower*, Investor-State Disputes under NAFTA: The Empire Strikes Back, 40 Columb. J. Transnat'l L. 43, 56 (2003). Similarly *Franck* (supra note 2), 73 Fordham L. Rev. 1521, 1589 (2005); *Vandevelde*, United States Investment Treaties: Policy and Practice, p. 76 (1992). See also *Dolzer* (supra note 8), 39 Int'l Law. 87, 89 (2005) (suggesting that states deliberately included this general standard as a gap-filling clause).

34 See for example *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 365 (2005) (explaning that fair and equitable treatment "is susceptible of specification through judicial practice".); *Dolzer* (supra note 8), 39 Int'l Law. 87, 105 (2005) (concluding that the task with respect to fair and equitable treatment consists in "developing a body of jurisprudence tailored to the specific structures of foreign investment and acceptable to investors, the host state and the home state".).

35 *Porterfield* (supra note 1), 27 U. Pa. J. Int'l Econ. L. 79, 103 *et seq.* (2006). For the contrary view see supra note 33.

36 Alternatively, host states may even abstain from regulation due to this insecurity. International investment treaties would then result in a "regulatory chill", possibly even in areas where regulation is not only necessary but even in the interest of foreign investors. In this sense see *Franck*, Occidental Exploration & Production Co. v Republic of Ecuador, 99 A.J.I.L. 675, 678 (2005).

C. Fair and Equitable Treatment as an Embodiment of the Rule of Law

In this chapter the paper presents an attempt to provide a normative framework of analysis for the interpretation and application of fair and equitable treatment. The argument forwarded is that fair and equitable treatment should properly be understood as an embodiment of the concept of the rule of law (or *Rechtsstaat* in the German, *état de droit* in the French tradition). The rule of law is a wide-spread concept of positive law that can be found with similar characteristics in most legal systems that adhere to liberal constitutionalism.[37] Relying on a common tradition,[38] the main thrust of the rule of law is the aspiration to subject public power to legal control[39] and can be paraphrased with the words of *F. A. Hayek*: "stripped of all technicalities this means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge".[40]

The rule of law primarily refers to the formal quality of law as providing guidance for human affairs and comprises the institutional aspiration that government has to use law as a means of exercising power.[41] First, the rule of law translates into procedural requirements for the deployment of legal processes[42] and mandates that "individuals whose interests are affected by the decisions of […] officials have certain rights", such as "the right to a hearing before a decision is made, the right to have the decision made in an unbiased and impartial fashion, the right to know the basis of the decision so that it can be contested, the right to reasons for the official's decision, and the right to a decision that is reasonably justified by all relevant legal and factual considerations."[43] Hence, the rule of law requires that the affected individual is recognized as a subject with certain rights which have to be taken into account in the decision making process of public authorities. In addition to the recognition of procedural rights, the rule of law is often also at the origin of the idea of

37 See *Schulze-Fielitz*, in: *Dreier* (ed.), Grundgesetz – Kommentar, Art. 20 par. 5 *et seq.* (vol. II 1998).

38 See on the development of the rule of law against its politico-philosophical background *Tamanaha*, On the Rule of Law – History, Politics, Theory (2004).

39 *Dyzenhaus*, The Rule of (Administrative) Law in International Law, 68 Law & Contemp. Probs. 127, 130 (2005); similarly *Waldron*, Is the Rule of Law an Essentially Contested Concept (in Florida)?, 21 Law & Philosophy 137, 158 (2002); *Hesse*, Der Rechtsstaat im Verfassungssystem des Grundgesetzes, in: *Forsthoff* (ed.), Rechtsstaatlichkeit und Sozialstaatlichkeit, p. 557, 560 *et seq.* (1968). As such, it should also be distinguished from other concepts of good and desirable government, such as human rights, democracy or justice; see *Raz*, The Rule of Law and its Virtue, 93 L. Quart. Rev. 195 *et seq.* (1977).

40 *Hayek*, The Road to Serfdom, p. 54 (1944).

41 See *Fallon*, "The Rule of Law" as a Concept in Constitutional Discourse, 97 Columb. L. Rev. 1, 14 *et seq.* (1997) on the formalist ideal in the rule of law.

42 See *Fallon* (supra note 41), 97 Columb. L. Rev. 1, 18 *et seq.* (1997) on the legal process ideal understanding of the rule of law.

43 *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 129 (2005).

proportionality, referring to the proper balance that has to be struck between the interests of the individual and competing public interests.[44] Secondly, the rule of law has implications for the institutional design of government. It mandates a basic separation of powers and the possibility to seek review of public acts by an independent judiciary.[45] Essentially it is this primarily formal understanding of the rule of law that prevails in many domestic legal traditions.[46]

In this sense, fair and equitable treatment can be understood as a rule of law standard that the legal systems of host states have to embrace as a standard for the treatment of foreign investors. While this may not seem much of a concretization given different historic developments and thrusts of the rule of law in different national legal systems and in light of the fact that the exact content and the requirements of the rule of law are often debated,[47] it nevertheless seems to constitute a viable approach to explain the normative content of fair and equitable treatment. A comparative analysis of municipal law reveals certain common ideas and standards that can be transferred to the international level and help to identify the paradigm features a state has to conform to in order to comply with the notion of "fairness and equitableness" in international investment law. Arguably, a comparative approach also constitutes a suitable methodological approach for the standard's interpretation and renders the outcome of investment disputes more predictable.

I. Principles Derived from Fair and Equitable Treatment

In view of the existing arbitral jurisprudence on fair and equitable treatment, seven specific normative principles can be discerned that occur in recurring fashion in the reasoning of arbitral tribunals and are presented as elements of fair and equitable treatment. These principles are (1) the requirement of stability, predictability and consistency of the legal framework, (2) the principle of legality, (3) the protection of investor confidence or legitimate expectations, (4) procedural due process and denial of justice, (5) substantive due process or protection against discrimination and arbitrariness, (6) the requirement of transparency and (7) the requirement of reasonable-

44 See on this thrust that has been developed particularly in the German tradition and has been taken up in the reasoning of the European Court of Human Rights and the European Court of Justice infra note 110.

45 *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 130 *et seq.* (2005).

46 See on the primarily formal tradition in Germany for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 13 *et seq.* Similarly, the due-process clause of the U.S. Constitution has mainly found a procedural interpretation; see *Shell*, Rechtsstaatlichkeit und Demokratie in den USA, in: *Tohidipur* (ed.), Der bürgerliche Rechtsstaat, p. 377 *et seq.* (1978). See also *Kantor* (supra note 14) on the decline of the substantive understanding of due process in the U.S. Supreme Court jurisprudence and its emphasis on procedure.

47 See only *Waldron* (supra note 39), 21 Law & Philosophy 137 (2002).

ness and proportionality. These principles also figure prominently as sub-elements or expressions of the broader concept of the rule of law in domestic legal systems.

1. Stability, Predictability, Consistency

International investment treaties in general seek to enhance the stability of the investment climate and reduce political risk.[48] Accordingly, one aspect that is recurrently invoked by investment tribunals as part of fair and equitable treatment is the concept of stability, predictability and consistency of the host state's legal framework. Based on the preamble in the United States-Argentina BIT that provides "that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources", the Tribunal in *CMS v. Argentina*, for example, found that "there can be no doubt […] that a stable legal and business environment is an essential element of fair and equitable treatment".[49] On this basis, the Tribunal found that the Argentine emergency legislation in 2001/2002 which entirely and permanently transformed the legal framework of the privatized gas sector violated fair and equitable treatment.[50] Likewise, the Tribunal in *OEPC v. Ecuador* held that "[t]he stability of the legal and business framework is thus an essential element of fair and equitable treatment".[51]

Similarly, the predictability of the legal framework governing the activity of foreign investors is frequently considered as an element of fair and equitable treatment. The Tribunal in *Metalclad v. Mexico*, for instance, based its finding of a violation of Art. 1105(1) NAFTA *inter alia* on the argument that Mexico "failed to ensure a […] predictable framework for Metalclad's business planning and investment".[52] The predictability of the legal framework was also evoked by the Tribunal in *Tecmed v. Mexico* when stressing that the foreign investor needs to "know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations".[53] Accordingly, a lack

48 *Rubins/Kinsella*, International Investment, Political Risk and Dispute Resolution, p. 1 *et seq.* (2005). See also *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction of June 17, 2003, par. 28 (regarding bilateral investment treaties as one of the "expressions of the search for stability and legal certainty" in international economic relations).

49 *CMS v. Argentina* (supra note 13), par. 274.

50 See for a fuller analysis of the case *Schill*, From Calvo to CMS: Burying an International Law Legacy – Argentina's Currency Reform in the Face of Investment Protection: The ICSID Case CMS v. Argentina, 3 SchiedsVZ/German Arb. J. 285 (2005).

51 See *Occidental Exploration and Production Company (OEPC) v. The Republic of Ecuador*, UNCITRAL, LCIA Case No. UN3467, Final Award of July 1, 2004, par. 183.

52 See *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of Aug. 30, 2000, par. 99.

53 *Tecmed v. Mexico* (supra note 27), par. 154.

of clarity of the legal framework or excessively vague rules can violate fair and equitable treatment.[54]

Finally, the concept of consistency plays an important role in the arbitral jurisprudence on fair and equitable treatment. The Tribunal in *Lauder v. Czech Republic*, for example, stressed this connection when it underscored that fair and equitable treatment could be violated if domestic agencies acted inconsistently in applying domestic legislation.[55] Similarly, in *MTD v. Chile* the Tribunal found a violation of fair and equitable treatment due to "the inconsistency of action between two arms of the same Government *vis-à-vis* the same investor".[56] Likewise, the Tribunal in *Tecmed v. Mexico* emphasized the need of consistency in the decision-making of a national agency in order to conform to fair and equitable treatment.[57]

These lines of argument run parallel to one of the central elements the concept of the rule of law is associated with in domestic legal systems: legal certainty and legal security (*Rechtssicherheit*).[58] This element of the rule of law refers to the core aspect of normativity of law that allows individuals to adapt their behavior to the requirements of the legal order and form stable social relationships. Especially in the commercial context stability is a critical component for long-term investment. Legal security requires a certain stability of the legal order, legal certainty calls for predictable and understandable rules and their consistent application. This interpretation notably conforms with the object and purpose of international investment treaties, as stability, predictability and consistency are necessary for investors in order to plan and calculate their investment and adjust to the legal framework in the host country.

Yet, one has to be aware that stability and predictability of domestic law can only relate to the normal deployment of governmental law- and policy-making and, parallel to the function of the rule of law in domestic constitutional law, should not be

54 See for example *OEPC v. Ecuador* (supra note 51), par. 184 (criticizing the vagueness of a change in the domestic tax law that did not "provid[e] any clarity about its meaning and extent").

55 *Lauder v. Czech Republic* (supra note 13), par. 292 *et seq.* In the case at hand, a regulatory agency had commenced an administrative proceeding against a television broadcasting company for non-compliance with the domestic Media Law due to allegedly unauthorized broadcasting without the necessary license. The Tribunal declined to find a violation of fair and equitable treatment by arguing that there were understandable grounds why the agency had initiated administrative proceedings. It also pointed out that inconsistent conduct of domestic agencies could not be assumed if the conduct consisted in enforcing domestic law, unless there was a specific undertaking to refrain from doing so.

56 *MTD v. Chile* (supra note 18), par. 163.

57 *Tecmed v. Mexico* (supra note 27), par. 154, 162 *et seq.* See also *OEPC v. Ecuador* (supra note 51), par. 184.

58 As such it is recognized, mostly as a constitutional standard, in many domestic legal systems. See for its implementation in the German Constitution *Schulze-Fielitz* (supra note 37), Art. 20 par. 117 *et seq.*; see *Fallon* (supra note 41), 97 Columb. L. Rev. 1, 14 *et seq.* (1997) with references to U.S. constitutional practice; more generally, see also *Raz* (supra note 39), 93 L. Quart. Rev. 195, 198 (1977).

understood as an absolute requirement that would allow foreign investors to be effectively excluded from regulatory changes in the host state.[59] Accordingly, stability and predictability should not be misunderstood as a guarantee that the legal framework will never change or even serve as a business guarantee to investment projects.[60] Likewise, the stability of the legal order will vary with the circumstances host states might have to react to: a serious crisis or even an emergency situation may call for different reactions than the deployment of public power in the normal course of things.[61] Concerning consistency, one should be aware that domestic regulatory frameworks are never completely free of inconsistencies.[62] A violation of this sub-element should therefore be handled in a prudent manner.

2. Legality

Fair and equitable treatment has also been interpreted by arbitral tribunals as including the principle of legality. In various cases tribunals based their assessment of fair and equitable treatment on an appreciation of whether domestic actors obeyed national legal provisions governing the conduct in question. Although tribunals diverge on the question to which extent the correct application of domestic law is subject to scrutiny by arbitral tribunals, their jurisprudence is consistent in holding that a violation of domestic law can constitute a violation of fair and equitable treatment.[63] This obligation applies to the domestic judiciary as well as to adminis-

59 In this sense also *Dolzer* (supra note 8), 39 Int'l Law. 87, 105 (2005).

60 See only *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award of Nov. 13, 2000, par. 64 ("emphasiz[ing] that Bilateral Investment Treaties are not insurance policies against bad business judgments"); *Marvin Roy Feldman Karpa v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award of Dec. 16, 2002, par. 112 (noting "that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c)").

61 See, for example, the *ELSI Case* (supra note 27), par. 74: "Clearly the right [to control and manage a company] cannot be interpreted as a sort of warranty that the normal exercise of control and management shall never be disturbed. Every system of law must provide, for example, for interferences with the normal exercise of rights during public emergencies and the like."

62 *Franck* (supra note 36), 99 A.J.I.L. 675, 678 (2005).

63 Although some tribunals held that a violation of domestic law in itself is not a violation of fair and equitable treatment, such as *ADF v. United States* (supra note 11) (stressing explicitly that "something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1)"), I rather do not interpret this as requiring an additional or qualified violation of domestic law but instead see this as a question of the standard of review of international tribunals that may depend on the procedural posture of the case, the applicable law, the question whether local remedies were exhausted etc.

trative agencies, and has even been alluded to concerning the question whether the activity of the domestic legislator was in conformity with the national constitution.[64]

In *Metalclad v. Mexico*, for instance, one factor for the Tribunal's finding of a violation of fair and equitable treatment was the apparent misapplication of a construction law by a local municipality.[65] Similarly, in *Pope & Talbot v. Canada* the Tribunal relied on the lack in competence of a domestic agency for initiating administrative proceedings against a foreign investor. Instead of relying "on naked assertions of authority and on threats that the Investment's allocation could be cancelled, reduced or suspended for failure to accept verification", the Tribunal emphasized that "before seeking to bludgeon the Investment into compliance, the SLD [i. e. the administrative agency] should have resolved any doubts on the issue and should have advised the Investment of the legal basis for its actions".[66] Here, the failure to produce a legal basis for the administrative proceedings under domestic law was therefore taken into account as one aspect for the violation of fair and equitable treatment.

Fair and equitable treatment was also interpreted to include an obligation to apply domestic law. In *GAMI Investments, Inc. v. Mexico* the Tribunal deduced from fair and equitable treatment an obligation to not only abide by but also to enforce existing provisions of national law.[67] Similarly, in *Tecmed v. Mexico* the Tribunal underscored that host states have to make use of "the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments".[68]

The connection between fair and equitable treatment and the principle of legality does, however, not only become apparent when domestic decision-makers violate municipal laws. On the contrary, the observance of domestic legal rules is often relied upon by tribunals in order to deny a violation of fair and equitable treatment. In *Noble Ventures v. Romania*, for example, the Tribunal observed that certain bankruptcy proceedings "were initiated and conducted according to the law and not against it"[69] and accordingly denied a violation of fair and equitable treatment. Similarly, in *Lauder v. Czech Republic* the Tribunal emphasized that a violation of fair and equitable treatment was usually excluded in case of a "regulatory body taking the necessary actions to enforce the law".[70]

64 See *CMS v. Argentina* (supra note 13), par. 119 *et seq.*

65 *Metalclad v. Mexico* (supra note 52), par. 93.

66 *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL/NAFTA, Award on the Merits of Phase 2 of April 10, 2001, par. 174 *et seq.*

67 *GAMI Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL/NAFTA, Final Award of Nov. 15, 2004, par. 91: "It is in this sense that a government's failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105."

68 *Tecmed v. Mexico* (supra note 27), par. 154.

69 *Noble Ventures v. Romania* (supra note 21), par. 178.

70 *Lauder v. Czech Republic* (supra note 13), par. 297.

The decisions therefore clearly consider the principle of legality as an element of fair and equitable treatment. The principle of legality also finds its counterpart in rule of law concepts that encompass the requirement that public power derives its authority from a legal basis and is exercised along the lines of pre-established procedural and substantive rules.[71] The principle of legality should, however, not distract from the fact that fair and equitable treatment does not simply buttress the application of domestic law and provide a claim of the foreign investor against the host state to apply its domestic law correctly. Rather, fair and equitable treatment remains an independent standard of international law against which the domestic legal order is measured.

3. Protection of Confidence and Legitimate Expectations

While the principle of legality is closely related to the idea that the executive and the judicial branch of government have to obey the law enacted by the legislator, legal rules are only able to have a stabilizing function for social relationships and create the basis of an environment conducive to long-term investment when they are applied according to how a reasonable investor would expect them to be applied. The ordering function of law therefore requires taking into account the perceptions of the law's subject and their expectations vis-à-vis government activity.

Accordingly, the concept of legitimate expectations is emerging as another prominent sub-element of fair and equitable treatment in arbitral practice. The Tribunal in *Saluka v. Czech Republic* referred to the concept of legitimate expectations even as "the dominant element of that standard".[72] Its existence can also be traced as an element of the rule of law in domestic legal systems[73] and as a concept of general international law.[74] Its main thrust in this context is the protection of confidence against administrative and legislative conduct. In this sense, the Tribunal in

71 In the German constitutional tradition this element of the rule of law is designated as "Gesetzmäßgkeit der Verwaltung" and "Vorrang des Gesetzes". See *Schulze-Fielitz* (supra note 37), Art. 20 par. 83 *et seq.*

72 *Saluka v. Czech Republic* (supra note 19), 301.

73 See *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 133 *et seq.* (2005) with reference to case law in Australia and the UK; *Schulze-Fielitz* (supra note 37), Art. 20 par. 134 *et seq.* concerning German Constitutional Law; *Schønberg*, Legitimate Expectations in Administrative Law (2000) on English, French and EC/EU law; *Dyer*, Legitimate Expectations in Procedural Fairness after Lam, in: *Groves* (ed.), Law and Government in Australia, p. 184 *et seq.* (2005) on Australian law; see also *Woehrling*, Le Principe de Confiance Légitime dans la Jurisprudence des Tribunaux, in: *Bridge* (ed.), Comparative Law Facing the 21st Century, p. 815 *et seq.* (1998) summarizing a comparative study by the XVth International Congress of Comparative Law, Bristol/UK in 1998.

74 See *Müller*, Vertrauensschutz im Völkerrecht (1971). See more specifically in the context of the law of expropriation of aliens *Dolzer*, New Foundations of the Law of Expropriation of Alien Property, 75 A.J.I.L. 553, 579 *et seq.* (1981).

Tecmed v. Mexico held that fair and equitable treatment requires "provid[ing] to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment".[75] Similarly, the Tribunal in *International Thunderbird Gaming Corporation v. Mexico* explained that "the concept of 'legitimate expectations' relates […] to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages".[76]

Legitimate expectations can result from a number of actions that are attributable to the host state.[77] In the first place, a breach of legitimate expectations will come into play if there is conduct "in breach of representations made by the host State which were reasonably relied on by the [investor]".[78] They can result, for example, from opinions and statements released by administrative agencies about the application of domestic law.[79]

It is, however, not necessary that expectations were induced by administrative action that was individually directed towards a foreign investor. Legitimate expectations can also originate from the provisions of the general regulatory framework which a host state has set into place[80] as long as the confidence the framework ge-

75 *Tecmed v. Mexico* (supra note 27), par. 154. The Tribunal's approach was also taken up in a number of other cases. See *ADF v. United States* (supra note 11), par. 189; *MTD v. Chile* (supra note 18), par. 114 *et seq.*; *OEPC v. Ecuador* (supra note 51), par. 185; *CMS v. Argentina* (supra note 13), par. 279; *Eureko B.V. v. Republic of Poland*, Partial Award of Aug. 19, 2005, par. 235, 241.

76 *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL/NAFTA, Arbitral Award of Jan. 26, 2006, par. 147 (internal citation omitted).

77 See on the connection between the expectations and government conduct *ADF v. United States* (supra note 11), par. 189, where the Tribunal declined to find a violation of Art. 1105(1) NAFTA in a case where the claimant argued that existing case law suggested that an agency would have to grant a waiver from a statutory local content requirement, noting that "any expectations that the Investor had with respect to the relevancy or applicability of the case law it cited were not created by any misleading representations made by authorized officials of the U.S. Federal Government but rather, it appears probable, by legal advice received by the Investor from private U.S. counsel."

78 *Waste Management v. Mexico* (supra note 25), par. 98. Similarly *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Partial Award of Sept. 13, 2001, par. 611 (arguing that the Respondent "breached its obligation of fair and equitable treatment by eviscerations of the arrangements in reliance upon which the foreign investor was induced to invest").

79 In *International Thunderbird Gaming v. Mexico* (supra note 76) the investor wanted to set up a gaming business in Mexico and sought a statement of the competent agency as to whether its gaming machines were in conformity with Mexican law that prohibited gambling and luck-related games. The Tribunal did, however, not consider the opinion given by the administrative agency as sufficiently specific so as to form the basis of legitimate expectations. See also *Metalclad v. Mexico* (supra note 52), par. 85 *et seq.* (concerning the violation of fair and equitable treatment pursuant to the (incorrect) statement of a government agency that the permits necessary to start building a waste landfill had been obtained).

80 See *GAMI v. Mexico* (supra note 67), par. 100.

nerated is sufficiently specific. In this context, the concept of legitimate expectations as an element of the rule of law may even restrict the domestic legislator in its decision-making concerning changes of the regulatory framework. This was the case in the dispute in *CMS v. Argentina*, where the regulatory framework the foreign investor relied upon when making his investment was permanently and fundamentally altered at a later stage.[81]

The concept entails, however, the danger that domestic legal orders and the actions of host states are exclusively measured against the expectations of foreign investors. Although the legitimacy of expectations already limits the scope of the concept,[82] it should not be handled as an inflexible and absolute yard-stick. Instead, tribunals should allow for a certain flexibility for host states to react, for example but not exclusively, to emergency situations. Accordingly, the Tribunal in *Eureko v. Poland* suggested that the breach of basic expectations was not a violation of fair and equitable treatment if good reasons existed why the expectations of the investor could not be met.[83] Similarly, the Tribunal in *Saluka v. Czech Republic* specifically warned of the danger of taking the idea of the investor's expectation too literally since this would "impose upon host States' [sic] obligations which would be inappropriate and unrealistic".[84] Instead, the Tribunal set out to balance the investor's legitimate expectations and the host state's interests within a broader proportionality test. It reasoned:

"No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. […]

The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.

A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to

81 See specifically on the concept of legitimate expectations in the context of this case *Costamagna*, Investors' Rights and State Regulatory Autonomy: the Role of the Legitimate Expectation Principle in the CMS v. Argentina Case, 3 TDM (issue 2, April 2006) p. 6 *et seq.* (available via http://www.transnational-dispute-management.com).

82 See *Saluka v. Czech Republic* (supra note 19), par. 304.

83 See *Eureko v. Poland* (supra note 75), par. 232 *et seq.*

84 *Saluka v. Czech Republic* (supra note 19), par. 304.

rational policies not motivated by a preference for other investments over the foreign-owned investment."[85]

Overall, the concept of legitimate expectations therefore offers sufficient flexibility to reconcile the interests of foreign investors and host states. The aim of achieving a balance between the protection of confidence and legitimate expectations and the public interest can also be mirrored in the concept of protection of confidence under domestic legal systems.[86]

4. Administrative Due Process and Denial of Justice

Several cases interpreted fair and equitable treatment so as to include the concept of due process. Due process, in this context, mainly comes in two forms: administrative and judicial due process.[87] It is thus closely connected to the proper administration of civil and criminal justice.[88] Recently, both an explicit reference to due process and the concept of denial of justice as part of fair and equitable treatment have been included in the treaty practice of the United States. Art. 10.5(2)(a) of the The Dominican Republic – Central America – United States Free Trade Agreement, for instance, stipulates that

"fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world".[89]

Even absent this explicit reference, investment tribunals have interpreted fair and equitable treatment in this way. The Tribunal in *Waste Management v. Mexico*, for instance, defined a violation of fair and equitable treatment as "involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process."[90] Similarly, for the

85 *Saluka v. Czech Republic* (supra note 19), par. 305 *et seq.*

86 See, for example, on the jurisprudence of the German Constitutional Court *Schulze-Fielitz* (supra note 37), Art. 20 par. 139 *et seq.*

87 The national legislator, so far, has not been subjected to any due process notions in investment arbitration. This could, however, be conceivable in the context of legislative expropriations since most BITs explicitly require host states to grant affected investors due process. See *Dolzer/Stevens* (supra note 20), p. 106 *et seq.* (1995).

88 See comprehensibly on the closely related concept of denial of justice in international law *Paulsson*, Denial of Justice in International Law (2005).

89 *The Dominican Republic – Central America – United States Free Trade Agreement*, signed Aug. 5, 2004, available at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section _Index.html. Similar provi sions can be found in a number of other recently concluded and currently negotiated free trade agreement of the United States, see *Kantor* (supra note 14).

90 *Waste Management v. Mexico* (supra note 25), par. 98.

Tribunal in *S.D. Myers v. Canada* fair and equitable treatment, among other elements, included "the international law requirements of due process".[91]

The main thrust of the due process requirement in investment treaty arbitration is to establish procedural rights for investors in administrative proceedings. This was emphasized by the Tribunal in *International Thunderbird Gaming v. Mexico* that held that the proceedings of a government agency "should be tested against the standards of due process and procedural fairness applicable to administrative officials".[92] Fair and equitable treatment is, however, equally relevant for the discharge of judicial proceedings.[93] In this context the standard can be violated "if Claimants were denied access to the courts […] or if the Claimants were treated unfairly in those courts (denial of procedural justice) or if the judgment of those courts were substantively unfair (denial of substantive justice)".[94]

5. Protection against Arbitrariness and Discrimination

The protection of foreign investors against arbitrary and discriminatory treatment also plays a major role in the operation of fair and equitable treatment. While sometimes international investment treaties contain a specific provision prohibiting such treatment, arbitral tribunals also ground this aspect in the concept of fair and equitable treatment. The connection between arbitrariness and the concept of the rule of law has been explicitly drawn by the decision of the International Court of Justice in the *ELSI Case*. Considering whether the requisition by the Mayor of Palermo of a foreign-owned factory in order to prevent its closure and the layoff of around 1000 workers, the Court observed that

"[a]rbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the *Asylum* case, when it spoke of 'arbitrary action' being 'substituted for the rule of law'. It is wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."[95]

Although the case arose under the Friendship, Commerce and Navigation Treaty between the United States and Italy, the decision has been widely accepted as being relevant for the interpretation of fair and equitable treatment in international invest-

91 *S.D. Myers v. Canada* (supra note 24), par. 134.
92 *International Thunderbird Gaming v. Mexico* (supra note 76), par. 200.
93 See *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic*, ICSID Case No. ARB/97/3, Award of Nov. 21, 2000, par. 80; *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of June 26, 2003, par. 132; *Waste Management v. Mexico* (supra note 25), par. 132.
94 *Aguas del Aconquija v. Argentina* (supra note 93), par. 80.
95 *ELSI Case* (supra note 27), par. 128 (internal citations omitted).

ment treaties.[96] The reason for this may be that arbitrary conduct can essentially be regarded as a qualified violation of the requirement to act in accordance with domestic law. Arbitrary conduct therefore can be seen as a sufficient but not as a necessary requirement for the violation of fair and equitable treatment. It can also be linked to the requirement under fair and equitable treatment to act in good faith.[97]

The nexus between fair and equitable treatment and the prohibition of discriminatory treatment has been emphasized in *Loewen v. United States*. Here, the Tribunal stated that fair and equitable treatment is violated by "[a] decision which is in breach of municipal law and is discriminatory against the foreign litigant".[98] Similarly, the Tribunal in *Waste Management v. Mexico* elaborated that "fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice".[99]

Other tribunals suggest drawing a clearer distinction between fair and equitable treatment and the prohibition of discriminatory conduct. They emphasize that "[c]ustomary international law does not […] require that a state treat all aliens (and alien property) equally, or that it treats aliens as favourable as nationals".[100] They only consider a violation of fair and equitable treatment if the investor was "specifically targeted" or if the differential treatment amounted to bad faith.[101]

96 See for example *Alex Genin v. Estonia* (supra note 13), par. 371; *Waste Management v. Mexico* (supra note 25), par. 98; *Noble Ventures v. Romania* (supra note 21), par. 176.

97 See *Waste Management v. Mexico* (supra note 25), par. 138: "A basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means"; *Alex Genin v. Estonia* (supra note 13), par. 367: "Acts that would violate [fair and equitable treatment] would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith." See also *Tecmed v. Mexico* (supra note 27), par. 154.

98 *Loewen v. United States* (supra note 93), par. 135.

99 *Waste Management v. Mexico* (supra note 25), par. 98; similarly *Eureko v. Poland* (supra note 75), par. 233 (finding that the state "acted not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character" and therefore breached fair and equitable treatment). *S.D. Myers v. Canada* (supra note 24), par. 266, also draws a parallel between national treatment and the fair and equitable treatment standard when stating: "Although […] the Tribunal does not rule out the possibility that there could be circumstances in which a denial of the national treatment provisions of the NAFTA would not necessarily offend the minimum standard provisions, a majority of the Tribunal determines that on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well."

100 *Alex Genin v. Estonia* (supra note 13), par. 368; similarly *Methanex Corporation v. United States of America*, UNCITRAL/NAFTA, Final Award of Aug. 3, 2005, Part IV - Chapter C par. 25.

101 *Alex Genin v. Estonia* (supra note 13), par. 369 and 371.

6. Transparency

A few cases have based a violation of fair and equitable treatment on a lack of transparency. The Tribunal in *Metalclad v. Mexico,* for instance, found that the respondent breached Art. 1105 NAFTA because "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment".[102] In a similar manner, the Tribunal in *Tecmed v. Mexico* connected the element of legitimate expectations to the requirement of transparency by stating:

"The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. "[103]

Especially, the decision in *Metalclad v. Mexico* has received major critique for interpreting fair and equitable treatment as including a transparency requirement and has been set aside by the Supreme Court of Columbia exercising jurisdiction under the British Columbia International Arbitration Act for this reason.[104] Yet, the Court seems to have over-interpreted the scope of the transparency requirement the Tribunal deduced from fair and equitable treatment.[105] Indeed, if transparency is considered to mean "that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments […] should be capable of being readily known to all affected investors" and requires the host state "to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws",[106] such an onerous standard risks to "overstretch the position and function of administrative agencies by developing them into consultative units and insurers for the implementation of foreign investment projects".[107]

Yet, a more restrictive reading of the transparency requirement seems equally possible and more closely related to the concept of the rule of law. In the *Tecmed-*

102 *Metalclad v. Mexico* (supra note 52), par. 99 (emphasis added).

103 *Tecmed v. Mexico* (supra note 27), par. 154; similarly *Maffezini v. Spain* (supra note 60), par. 83.

104 See Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation*, 2001 BCSC 644, available via http://www.investmentclaims.com.

105 In addition, it is questionable whether the domestic courts acted in conformity with the provisions of NAFTA when entertaining a claim to set aside a NAFTA award. See on this *Brower*, Investor-State Disputes Under NAFTA: The Empire Strikes Back, 40 Colum. J. Transnat'l L. 43 (2001).

106 *Metalclad v. Mexico* (supra note 52), par. 76 (for both citations).

107 *Schill*, Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case Tecmed, 3 TDM (issue 2, April 2006) p. 15 (available via http://www. transnational-dispute-management.com); for the original German version of this article see *Schill*, Völkerrechtlicher Investitions- und Eigentumsschutz in der ICSID-Entscheidung TECMED, in: 51 Recht der Internationalen Wirtschaft 330 (2005).

case, for example, transparency mainly referred to procedural aspects of administrative law, such as the requirement to give sufficient reasons[108] and the obligation to act in a comprehensible and predictable way.[109] Essentially, these statements only reiterate more general requirement of the rule of law that relate to the procedural position of foreign investors in administrative proceedings. Transparency does therefore not necessarily have to be viewed as an additional substantive requirement, but rather as an instrument of procedurally resolving uncertainty in the domestic law and closely interacts with the burden of proof. As a matter of procedural fairness complete uncertainties of domestic law should not be imposed to the detriment of the foreign investor who is less accustomed to the general legal and political culture of the host state. In that sense it is fully compatible with a procedural understandding of the rule of law and does not impose obligations upon host states to counsel foreign investors or provide them with comprehensive legal advice.

7. Reasonableness and Proportionality

Finally, arbitral tribunals often link fair and equitable treatment to the concept of reasonableness and proportionality. Such criteria also play an important role as part of the rule of law in many domestic legal systems, the law of the European Union

108 See *Tecmed v. Mexico* (supra note 27), par. 123: "administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies." Similarly, *Tecmed v. Mexico*, par. 164.

109 See *Tecmed v. Mexico* (supra note 27), par. 160: "The incidental statements as to the Landfill's relocation in the correspondence exchanged between *INE* and *Cytrar* or *Tecmed* […] cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as *Cytrar's* business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to *Cytrar* from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of *Cytrar*'s operations at the Landfill to another place".

and the jurisprudence of the European Court of Human Rights.[110] Its function, however, mainly consists in controlling the extent to which interferences of host states with foreign investments are permitted. In this light, the Tribunal in *Pope & Talbot v. Canada* repeatedly referred to the reasonableness of the conduct of an administrative agency in order to decline a violation of fair and equitable treatment.[111] The mitigating role of the principle of proportionality has also been applied in the decision in *Saluka v. Czech Republic* as a way to balance the host state's interest in upholding the stability of its banking sector with the expectations of the foreign investor.[112]

Another award that used proportionality as a concept restricting generally permissible interferences with foreign investments is the decision in *Tecmed v. Mexico*. Here, the Tribunal incorporated a proportionality test as a method to distinguish between a compensable indirect expropriation and a non-compensable regulation.[113] In the Tribunal's reasoning an indirect expropriation occurs whenever a restriction of the right to property is disproportionate:

"[T]he Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality. […] There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."[114]

Although integrating proportionality into the principle of fair and equitable treatment allows to a certain extent for a substantive control of host state conduct, the

110 See for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 167 *et seq.* on German constitutional law where the proportionality principle arguably finds its origins in modern positive constitutional law. See also *Ellis* (ed.), The Principle of Proportionality in the Laws of Europe (1999); on proportionality as a principle in EU/EC law *Emiliou*, *The Principle of Proportionality in European Law,* p. 23 et seq. (1996); *Nolte*, General Principles of German and European Administrative Law - A Comparison in Historic Perspective, 191 Mod. L. Rev. 191 (1994); see also *Gunn*, Deconstructing Proportionality in Limitations Analysis, 19 Emory Int'l L. Rev. 465 (2005). Proportionality is also a guiding principle in the interpretation of the European Convention on Human Rights, see *van Dijk/van Hoof*, Theory and Practice of the European Convention on Human Rights, p. 80 *et seq.* (1998). Critical however concerning the scope of the proportionality requirement in U.S. constitutional law in particular concerning criminal law in the context of the Eighth Amendment see *Ristroph*, Proportionality as a Principle of Limited Government, 55 Duke L. J. 263 (2005) with further references; see also on the hesitance in U.S. constitutional law to accept proportiona-lity as a general principle *Jackson*, Ambivalent Resistance and Comparative Constitutionalism: Opening up the Conversation on "Proportionality", Rights And Federalism, 1 U. Pa. J. Const. L. 583 (1999).

111 See *Pope & Talbot v. Canada* (supra note 66), par. 123, 125, 128, 155; see also *MTD v. Chile* (supra note 18), par. 109 with a reference to an expert opinion by *Schwebel*.

112 See above all *Saluka v. Czech Republic* (supra note 19), par. 304 *et seq.*

113 *Schill* (supra note 107), 3 TDM (issue 2, April 2006) p. 9 *et seq.*

114 *Tecmed v. Mexico* (supra note 27), par. 122.

proportionality requirement also clarifies that fair and equitable treatment is not an inflexible standard, but allows for the balancing of the interests of host states and foreign investors. As long as sufficient leeway is given for the implementation of domestic policies and as long as tribunals refrain from using it in order to establish an intrusive standard of review, proportionality constitutes a concept that helps to counter fears about the dominance of investors' rights over the interests of host states. Although the concept of proportionality as part of fair and equitable treatment is still in its infancy, it helps to reconcile the interests of foreign investors with the necessary implementation of regulatory policies by host states.

II. Contextualization of Fair and Equitable Treatment in the Separation of Powers Framework

Although the elements arbitral tribunals have developed in order to concretize the principle of fair and equitable treatment are of a fairly general nature, they can be further concretized in regard of the discharge of public power by the domestic administration, in domestic legal proceedings and national legislation. Fair and equitable treatment, thus, develops into increasingly specific requirements that national legal systems have to incorporate in order to comply with international investment treaties. Fair and equitable treatment therefore assumes a function that is compareable to domestic constitutional law, however with two modifications: it only constitutes a special regime for foreign investors and, only entitling to damages in case the host state violates its treaty obligations, does not assume normative supremacy.

1. Fair and Equitable Treatment and Domestic Administrative Law

National administrative law is particularly prone to the influence of fair and equitable treatment as foreign investors are affected by administrative proceedings at various stages of an investment project, reaching from the application for and issuance of operating licenses to the general regulatory control and supervision of their undertaking. In this context, several sub-elements of the standard establish rule of law components that serve as a yardstick for domestic administrative law. In this context, fair and equitable treatment becomes a *leitmotif* for structuring the relationship between investors and national administrations.[115] The rule of law elements that mainly influence domestic administrative law are the principle of legality, the protection of confidence and the requirement of due process. These elements influence, for example, the structure and process of administrative decision-making, account

115 *Schill* (supra note 107), 3 TDM (issue 2, April 2006) p. 13 *et seq.*

for procedural rights of foreign investors and may limit the exercise of administrative discretion.

a) Administrative Procedure

With respect to administrative procedure, in particular concerning the granting, renunciation or renewal of operating licenses, fair and equitable treatment requires domestic administrations to grant foreign investors a fair hearing, conduct proceedings in a comprehensible way and give reasons for their decisions. The right to a fair hearing and the right to participation in administrative proceedings played a role in the NAFTA case *Metalclad v. Mexico* where the Tribunal found a breach of fair and equitable treatment because the investor was not properly involved. According to the Tribunal the investor should have been given the chance to participate in a meeting of a local town council that discussed whether a construction permit was to be given for the investor's waste landfill.[116] Similarly, the Tribunal in *Tecmed v. Mexico* emphasized the right to a fair hearing as part of fair and equitable treatment in the context of an administrative proceeding that concerned the non-prolongation of an operating license for a waste landfill. It also stated that the standard required the national administration to take decisions about the requests of a foreign investor.[117]

Fair and equitable treatment further obliges the domestic administration to give reasons for their decisions and base them on sufficient factual evidence. The purpose of this requirement is to rationalize the decision-making process and to secure that decisions are taken in accordance with the legal requirements contained in domestic law. Against this backdrop, the Tribunal in *Metalclad v. Mexico* determined that Mexico had breached the fair and equitable treatment standard because the Town Council's decision to deny the construction permit was not grounded in considerations concerning "construction aspects or flaws of the physical facility"[118] but was mainly motivated by the opposition of the local population against the landfill. In the Tribunal's view, the decision was therefore not supported by evidence pertaining to legitimate criteria under the municipal construction law. The requirement to supply sufficient evidence also results in a duty to conduct fact-finding and to verify evidence before a final decision is taken. Furthermore, the requirement to give reasons aims at facilitating the legal review of an administrative decision.[119]

116 The Tribunal particularly pointed out that "the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear", *Metalclad v. Mexico* (supra note 52), par. 91.

117 See *Tecmed v. Mexico* (supra note 27), par. 161 *et seq.* More specifically on the elements of a fair hearing required under fair and equitable treatment *Weiler*, NAFTA Article 1105 and the Principles of International Economic Law, 42 Colum. J. Transnat'l L. 35, 79 *et seq.* (2003).

118 *Metalclad v. Mexico* (supra note 52), par. 93.

119 See *Tecmed v. Mexico* (supra note 27), par. 123.

Overall, fair and equitable treatment therefore requires that domestic administrative proceedings conform to standards that are derived from a process-oriented understanding of the rule of law.[120]

b) Exercise of Administrative Discretion

Fair and equitable treatment can also restrict or channel the exercise of the administration's discretionary power. The standard requires administrative agencies to sufficiently take into account the effect of their decisions on foreign investors. In addition, the element of consistency and the concept of legitimate expectations play an important role regarding the exercise of administrative discretion.

The case in *Middle East Cement Shipping and Handling Co S.A. v. Egypt*[121] involved the seizure and auctioning of the Claimant's vessel in order to recover debts the investor had incurred in relation to a state entity. Interestingly, the issue focused on the question whether the procedural implementation of the auction was valid, in particular whether sufficient notice of the seizure was given.[122] Arguably in conformity with Egyptian law, the notice was given by attaching a copy of a distraint report to the vessel, because the Claimant could not be found onboard the ship. The Tribunal, however, considered that the authority had wrongly exercised its discretion by using this *in absentia* notification instead of notifying the Claimant directly at his local address. Relying on the principle of fair and equitable treatment in interpreting the due process requirement in the expropriation provision of the Greek-Egyptian BIT, the Tribunal reasoned that

"a matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication […] irrespective of whether there was a legal duty or practice to do so by registered mail with return receipt".[123]

The exercise of administrative discretion can also be limited by the principle of consistency and the concept of legitimate expectations. Consistency requires that administrative agencies exercise their discretion according to uniform standards and do not deviate from standard procedures or the usual assessment of comparable circumstances. Consistency may not only influence administrative decision-making

120 See for parallel developments of transnational administrative law in the context of administrative proceedings in the EU/EC and similar developments under WTO law *della Cananea*, Beyond the State: the Europeanization and Globalization of Procedural Administrative Law, 9 Eur. Publ. L. 563 (2003).

121 *Middle East Cement Shipping and Handling Co S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award of April 12, 2002.

122 The issue turned around the question whether the seizure yielded the requirement of due process in the provision prohibiting direct and indirect expropriations without compensation in the Egyptian-Greek BIT and the principle of fair and equitable treatment.

123 *Middle East Cement Shipping v. Egypt* (supra note 121), par. 143.

with respect to the granting of licenses,[124] but can also restrict the intervention by administrative agencies in order to enforce domestic law. If, for example, the domestic administration has consistently tolerated a specific unlawful conduct, fair and equitable treatment may prevent them from intervening against a foreign investor who engaged in the same conduct. Similarly, legitimate expectations of the investor can reduce the administration's discretionary power. Acting contrary to representations made by government officials, for instance, constitutes a breach of fair and equitable treatment.[125]

2. Fair and Equitable Treatment and Domestic Judicial Proceedings

The rule of law elements derived from fair and equitable treatment also influence the institutional structure of the host state's judiciary and the procedural law they apply. Fair and equitable treatment requires that host states provide a fair and efficient system of justice,[126] including effective judicial dispute settlement procedures for the review of administrative acts[127] and dispute settlement between private parties.[128] In *Mondev v. United States* the Tribunal, for example, entertained the possibility that "the conferral of a general immunity from suit for conduct of a public authority affecting a NAFTA investment could amount to a breach of Article 1105(1) of NAFTA".[129] In *Azinian v. Mexico* the Tribunal pointed out that "a denial of justice could be pleaded if the relevant courts refused to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way".[130] Accordingly, fair and equitable treatment grants a right to access to domestic courts for foreign investors.

Similarly, the procedural law applied by domestic courts has to conform to the rule of law requirements stemming from fair and equitable treatment. This requires

124 See *MTD v. Chile* (supra note 18), par. 107 *et seq.*

125 See *International Thunderbird Gaming v. Mexico* (supra note 76), par. 137 *et seq.*; *Metalclad v. Mexico* (supra note 52), par. 85 *et seq.*

126 *Loewen v. United States* (supra note 93), par. 153 with further references.

127 *Cf,* also *Waste Management v. Mexico* (supra note 25), par. 116: "the availability of local remedies to an investor faced with contractual braches is nonetheless relevant to the question whether a standard such as article 1105(1) have [sic] been complied with by the State."

128 *Loewen v. United States* (supra note 93), par. 129: "customary law is concerned with the denial of justice in litigation between private parties"; *ibid.*, par. 123: "it [is] the responsibility of the State under international law and, consequently, of the courts of a State, to provide a fair trial of a case to which a foreign investor is a party. It is the responsibility of the courts of a State to ensure that litigation is free from discrimination against a foreign litigant and that the foreign litigant should not become the victim of sectional or local prejudice."

129 See *Mondev v. United States* (supra note 10), par. 151 (concluding, however, that the immunity granted to a municipal authority in the case at hand was not a violation of fair and equitable treatment).

130 *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States*, ICSID Case No. ARB (AF)/97/2, Award of Nov. 1, 1999, par. 102.

courts to entertain suits in a timely fashion, to give a fair hearing to the foreign investor on all essential questions, not to base a decision on unexpected legal grounds and give reasons for the decisions reached.[131] In essence, concerning the judicial proceedings the obligations stemming from fair and equitable treatment will be similar to the obligations arising under human rights instruments, such as Art. 6 of the European Convention on Human Rights.[132]

3. Fair and Equitable Treatment and Domestic Legislation

Finally, fair and equitable treatment also affects the way national legislation deals with foreign investors.[133] Although domestic legislation is only rarely subject to the assessment of investment tribunals, mainly due to the fact that it often requires specific implementation by administrative or judicial decisions and does not affect foreign investors directly,[134] fair and equitable treatment can result in significant restrictions of the domestic legislator, mainly based on the rule of law element of legitimate expectations or protection of confidence.

So far the apparently only case that concerned the impact of fair and equitable treatment on the domestic legislator is the dispute in *CMS v. Argentina*. Although the Tribunal emphasized that it "does not have jurisdiction over measures of general economic policy […] and cannot pass judgment on whether they are right or wrong […] it has jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct

131 See *Azinian v. Mexico* (supra footnote 130), par. 102. To a lesser extent fair and equitable treatment may also require the outcome of a legal decision to conform to substantive rule of law standards or, as expressed by the Tribunal in *Aguas del Aconquija v. Argentina* (supra note 93), par. 80: "substantive justice".

132 *European Convention for the Protection of Human Rights and Fundamental Freedoms and its protocols*, 4 Nov. 1950, 213 U.N.T.S. 222. For this analogy see *Mondev v. United States* (supra note 10), par. 144. Compare also Art. 19(4) of the German Basic Law that provides for a guarantee to have judicial recourse against acts of public authority.

133 Under general international law it is established that the internal law of a state cannot be invoked as a justification for its failure to perform a treaty, see Art. 27 of the Vienna Convention on the Law of Treaties. As a consequence, the breach of an international obligation by the domestic legislator entails state responsibility since acts of the legislator can constitute internationally wrongful acts. Art. 4(1) of the ILC Draft Articles on State Responsibility. See for further authority *International Law Commission,* Commentary on the Draft Articles on State Responsibility, Art. 4 par. 4 (2001), available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

134 *Cf.* on the question of the self-executing nature of expropriatory legislation *Jahangir Mohtadi, et al. and The Government of the Islamic Republic of Iran*, Award No. 573-271-3 (2 Dec. 1996), 32 Iran-U.S. C.T.R. 124, 140 *et seq.*; *Reza Said Malek and The Government of the Islamic Republic of Iran*, Final Award No. 534-193-3 (11 Aug. 1992), 28 Iran-U.S. C.T.R. 246, 266 *et seq.*

bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[135]

On the merits, the Tribunal in *CMS v. Argentina* specified that transparency, consistency in the governmental decision making process, orderly process and predictability constituted the core elements of fair and equitable treatment also with respect to national legislation.[136] Measures that entirely converted the existing legal framework, such as the fundamental change in the U.S. dollar-based tariff calculation that the investor relied upon when making its initial investment decision, were found to breach fair and equitable treatment. Arguably, the key factor in this context was the permanent abrogation of the existing tariff system that completely waived the central promises made vis-à-vis the investor and breached his expectations.[137]

Yet, the protection of confidence should not be interpreted as an absolute guarantee. Rather, as the Tribunal in *Saluka v. Czech Republic* rightly pointed out, "[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged".[138] Although the stability of the legal framework is an essential factor for the investment decision of foreign investors, one cannot presume that host states denounced their right to legislate and change domestic legal rules by entering into international investment treaties. Concerning the concept of legitimate expectations, it therefore seems appropriate to draw a distinction between situations where a host state has incited specific confidence in the stability of certain regulations and situations where a foreign investor merely relied on the regulatory framework of the host state in a more general way.

In the first case, the concept of legitimate expectations will find its genuine application. Not only are expectations in this context directly attributable to a host state, but moreover did the host state know about the specific weight the foreign investor placed on the regulatory infrastructure in making its investment decision. Yet, absent specific commitments, legitimate expectations will not operate so as to prevent any changes in the regulatory framework. Based on the principle of proportionality, in particular emergency situations may justify even severe interferences.[139]

In the second case, where a foreign investor merely relies on the general legal framework without any specific commitments or intention on behalf of the host state to attract foreign investors, the concept of legitimate expectations may only have a more marginal scope of application. It will mostly come into play with respect to legislation with a retroactive affect.[140] Apart from that, it is difficult to imagine

135 *CMS v. Argentina* (supra note 48), Decision on Jurisdiction, par. 33.
136 *CMS v. Argentina* (supra note 13), par. 276 *et seq.* with further references.
137 See also *Costamagna* (supra note 81), 3 TDM (issue 2, April 2006), p. 6 *et seq.*
138 *Saluka v. Czech Republic* (supra note 19), par. 305.
139 Compare *Christie*, What Constitutes a Taking of Property Under International Law?, 38 Brit. Yb. Int'l L. 307, 331 (1962) (noting that in the context of expropriation the purpose of a host state's conduct may justify "even severe, although by no means complete, restrictions on the use of property").
140 See for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 139 *et seq.*

cases of legislative regulatory change that violate fair and equitable treatment but do not at the same constitute measures with an expropriatory effect.

III. Methodological Implications of the Rule of Law Approach

Understanding fair and equitable treatment as an embodiment of the rule of law does not only clarify its normative content, it also suggests a specific methodology investment tribunals should follow in concretizing the standard and in solving conflicts between the sometimes competing interests of host states and foreign investors. Instead of primarily relying on prior arbitral decisions, an approach that is little helpful in particular when disputes concern novel circumstances, or positing the content of fair and equitable treatment in an abstract way without sufficient justification, tribunals should use a comparative method that draws on domestic and international law regarding the concept of the rule of law. These bodies of law can elucidate the meaning and specific implications of rule of law requirements.

1. Comparative Analysis of Domestic Legal Systems

The first approach relies on a comparative approach to rule of law standards contained in the major domestic legal systems that adhere to a liberal tradition. This approach essentially relies on the attempt to extract general principles of law in order to concretize fair and equitable treatment. This approach has also been proposed in order to concretize the concept of indirect expropriation under international law and its distinction from non-compensable regulation.[141] With respect to the concept of the rule of law, such an approach can be made equally fruitful for the application of fair and equitable treatment. Arbitral tribunals should therefore engage in a comparative analysis of the major domestic legal systems in order to grasp common features those legal systems establish for the exercise of public power.

Such a comparative analysis may influence the interpretation of fair and equitable treatment mainly in two respects. First, it may enable investment tribunals to positively deduce institutional and procedural requirements from the domestic rule of law standards for a context-specific interpretation of fair and equitable treatment. A comparative analysis of domestic legal systems and their understanding of the rule of law may, for example, be used to justify the standards administrative proceedings

141 *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht, p. 213 *et seq.* (1985); *Dolzer*, Indirect Expropriation of Alien Property, 1 ICSID Rev. - Foreign Inv. L. J. 41 (1986). Similarly *Salacuse/Sullivan*, Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain, 46 Harv. Int'l L. J. 67, 115 (2005).

affecting foreign investors have to live up to.[142] Secondly, a comparative analysis of the implications of the rule of law under domestic law may be used to justify the conduct of a state vis-à-vis a foreign investor under the fair and equitable treatment standard. If similar conduct, for instance the repudiation of an investor-state contract in an emergency situation, is generally accepted by domestic legal systems as being in conformity with their understanding of the (national) rule of law, investment tribunals can transpose such findings to the level of international investment treaties as an expression of a general principle of law.

2. Comparative Analysis of International Legal Regimes

The second methodological approach relies on a cross-regime comparison with other international law regimes that incorporate rule of law standards. A particularly promising field for such an approach is the comparative evaluation of the jurisprudence developed by international courts in the human rights context that address specific elements of the rule of law. The primary example in this context is the jurisprudence of the European Court of Human Rights (ECtHR) concerning Art. 6 of the European Convention on Human Rights (ECHR). This provision can be viewed as an expression of a more general standard of an institutional and procedural understanding of the rule of law.[143] The rich jurisprudence of the ECtHR could thus be used to further concretize fair and equitable treatment, for example with respect to the timely administration of justice or the right to a fair trial.[144] Similarly, comparative recourse could be had to the emerging principles of European administrative law[145] or the jurisprudence of the WTO Appellate Body in order to further develop the rule of law requirements with respect to the exercise of public power.[146] The comparative analysis of rule of law understandings under both domestic legal sys-

142 See also *della Cananea* (supra note 120), 9 Eur. Publ. L. 563, 575 (2003) (explaining that the WTO Appellate Body in the *Shrimps* Case has "subsumed from national legal orders some general or 'global' principles of administrative law" in order to impose procedural rule of law elements on the exercise of public power by WTO Member States).

143 This approach has occasionally already played a role in investment arbitration. See *Mondev v. United States* (supra note 10), where parallels were considered between Art. 7 ECHR (freedom from non-retrospective effect of penal legislation) and Art. 1105 NAFTA (par. 138) and between the assessment of granting immunity to a state agency under Art. 1105 NAFTA and Art. 6 ECHR (par. 141 et seq.). Another example of an investment tribunal that drew a parallel between the jurisprudence of the European Court of Human Rights and the Inter-American Court of Human Rights in the context of indirect expropriation is *Tecmed v. Mexico* (supra note 27), par. 166, 122.

144 For an account of the jurisprudence of the European Court of Human Rights concerning Art. 6 ECHR, see *van Dijk/van Hoof*, Theory and Practice of the European Convention on Human Rights, p. 391 *et seq.* (1998).

145 See, for example, *Schwarze*, Europäisches Verwaltungsrecht (2nd ed. 2005).

146 See *della Cananea* (supra note 120), 9 Eur. Publ. L. 563, 575 (2003).

tems and other international law regimes should be able to give examples for the effect of the rule of law and the scope of restrictions it imposes on states and thus help to inform the content of fair and equitable treatment in international investment law. Yet, it will, always be necessary to keep in mind the specific context of international investment treaties which aim at protecting and promoting foreign investment between the contracting state parties.

D. A Normative Justification of the Rule of Law Approach

Explaining the various context-specific implementations and sub-elements derived from fair and equitable treatment as an embodiment of the rule of law can also be normatively grounded in international investment treaties by linking this understanding to the intentions of the contracting state parties as expressed in the object and purpose of international investment treaties. This teleology can be instrumentalized in order to equate fair and equitable treatment with the concept of the rule of law as a guiding and restricting principle for the exercise of public power by host states. In particular, institutional economics suggest that the concept of the rule of law contributes to the promotion of foreign investment and, more generally, economic growth and development.

I. The Teleology of International Investment Treaties

As expressed in their preambles, international investment treaties aim not only at protecting but also at promoting foreign investment.[147] Investment flows will, however, depend on the decision of foreign investors to invest in a certain country. One critical factor for this investment decision is the political risk of the host country.[148] Consequently, international investment treaties intend to establish a legal regime

147 See *Dolzer/Stevens* (supra note 20), p. 11 *et seq.*, 20 *et seq.* (1995). See in general on the effects of bilateral investment treaties on actual flows of foreign investment *Neumayer/Spess*, Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?, 33 World Development 1567 (2005); *Salacuse/Sullivan* (supra note 141), 46 Harv. Int'l L. J. 67 (2005); *Tobin/Rose-Ackerman*, Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties, Yale Law School Center for Law, Economics and Public Policy Research Paper No. 293. (all suggesting, albeit to differing degrees the existence of an empirical link between the existence of BITs, the domestic policy framework and actual investment flows).

148 On the connection between international investment treaties and the reduction of political risk see *Rubins/Kinsella* (supra note 48), p. 1 *et seq.* (2005).

that reduces the political risk associated with foreign investment in order to increase investment flows between the contracting parties[149].

The mechanisms for the protection and promotion of foreign investment are, however, not an end in themselves. They are rather closely related to the goals of economic growth and development, in particular in developing countries. This was explicitly mentioned as an objective of the ICSID Convention that recognized "the need for international cooperation for economic development, and the role of private international investment therein".[150] The link between the inflow of foreign investment and economic development is further reinforced by the character of the World Bank as a development institution.[151] The implementation of an investor-state dispute settlement mechanism under the ICSID Convention aimed at reducing the political risk connected with investing in a developing country with weaker domestic institutions and a less stable legal and political infrastructure in the interest of growth and development.[152] Accordingly, from a macroeconomic perspective foreign investment is perceived as "a supplement to a necessarily limited volume of public development finance".[153]

II. Institutional Economics and the Role of the Rule of Law

Institutional economics help to explain the function of the rule of law with respect to both objectives of international investment treaties, i. e. the promotion of foreign investment and economic growth and development. Institutional economics analyze the relationship between institutions, markets and growth. Institutions, in this context, are "rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction."[154] Institutions are characterized by con-

149 See *Vandevelde*, The Economics of Bilateral Investment Treaties, 41 Harv. Int'l L. J. 469, 478 *et seq.* (2000) (concluding at 490 that the "principal contribution [of bilateral investment treaties] to increasing investment is to reduce risk for investors and thereby provide some inducements for those investments that the host state desires").

150 See the preamble of the ICSID Convention.

151 *Broches*, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 136 Recueil des Cours 331, 342 *et seq.* (1972-II); *Schöbener/Markert*, Das International Centre for Settlement of Investment Disputes (ICSID), 105 ZVglRWiss 65, 67 (2006).

152 See for an overview on the contentious question to what extent foreign investment actually contributes to economic growth *Cosbey*, International Investment Agreements and Sustainable Development: Achieving the Millenium Development Goals, p. 11 *et seq.* (2005), available at http://www.iisd.org/pdf/2005/investment_iias.pdf.

153 *Broches* (supra note 151), 136 Recueil des Cours 331, 343 (1972-II).

154 *North*, Institutions, Institutional Change, and Economic Performance, p. 3 (1990). See also *North*, Structure and Change in Economic History, p. 201 *et seq.* (1981) (defining institutions as "a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals").

straints with a certain permanence and durability which are imposed on actors.[155] They comprise legal rules that impose restrictions on the behavior of individuals as well as legal requirements that concern the exercise of public power. Institutions thus have a double thrust in avoiding private disorder, on the one hand, as well as public dictatorship on the other.[156] They are also essential for the functioning of markets as they "structure incentives in human exchange, whether political, social, or economic".[157] In this sense, the rule of law as a concept of restricting public power can be properly understood as an institution that constitutes one of the bases of market economies.

With respect to the immediate objective of international investment treaties, the concept of the rule of law is important in the context of attracting investment into foreign, particularly developing countries. This becomes clear from an empirical perspective. According to a survey by the World Bank, investors primarily make their decision to invest dependent upon the credibility of states to ensure a predictable and stable legal framework, or – in other words – to effectively implement the rule of law.[158] Conversely, government activity and domestic legal procedures that do not adhere to the concept of the rule of law constitute a critical deterrent for an investment decision in a specific country. Government according to the rule of law is therefore a prerequisite for risk-adverse investment decisions in a specific country. This fact should influence the interpretation of international investment treaties, in particular concerning the principle of fair and equitable treatment.

Yet, the rule of law does not only influence the foreign investor's microeconomic perspective. Instead, institutional economics also suggest a link between the rule of law and the broader objective of international investment treaties, i. e. economic growth and development, because "[e]conomic institutions matter for economic growth because they shape the incentives of key economic actors in society, in particular, they influence investments in physical and human capital and technology, and the organization of production."[159]

The importance of the rule of law in the decision making process of economic actors has been highlighted in economic literature since its earliest days. *Max Weber* was among the first scholars to argue for the interdependence of the emergence of modern forms of growth-creating market-economies in Western civilizations and a

155 See *Glaeser/La Porta/Shleifer*, Do Institutions Cause Growth?, 9 J. Econ. Growth 271, 275 (2004).

156 See for this double thrust in evaluating the rule of law as an economic institution *Djankov/Glaeser/La Porta/Lopez-de-Silanes/Shleifer*, The New Comparative Economics, 31 J. Comp. Econ. 595 (2003).

157 *North* (supra note 154), p. 3 (1990).

158 *World Bank*, *World Development Report – The State in a Changing World* 5, p. 34 *et seq.* (1997).

159 *Acemoglu/Johnson/Robinson*, Institutions as the Fundamental Cause of Economic Growth, Working Paper 10481, NBER Working Paper Series, p. 2, available at http://www.nber.org/papers/w10481.

modern legal system based on rational and predictable rules.[160] For him, the core explanation for economic growth in Europe was the rationality of the legal institutions, including the existence and enforcement of contracts and property rights, which had emerged in the socio-legal discourse in the 18th and 19th century and subsequently paved the way for the development of modern market economies.[161] *Weber* thus showed that modern law "helps structure the free market system".[162]

Although *Weber* primarily focused on the function of legal institutions to create horizontal order between private individuals by enabling them to use private law institutions for purposes of private ordering, institutions are also critical in the relationship between the state and society. In this context, the rule of law is the primary and, at the same time, most general expression for the predictable exercise of public power vis-à-vis the individual. This aspect complements the function of the rule of law as an institution that aims at not only avoiding private disorder but also public dictatorship.[163] It is also the aspect that grasps the public law understanding of the concept and its function of limiting the exercise of public power.

This aspect has been described as an important factor for the functioning of market economies and economic growth. Already *Adam Smith* noted that

"[c]ommerce and manufacturers can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufacturers, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government."[164]

Similarly, *F. A. Hayek* underscored the importance of the rule of law's restraining function with respect to public authority for modern market economies and economic growth. For him, "[n]othing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law."[165] In his reasoning,

160 *Weber*, Wirtschaft und Gesellschaft – Grundriss der verstehenden Soziologie (4th ed. *J. Winckelmann*, 1956).

161 For a short and informative summary of *Weber's* account of the relationship between law and economic growth see *Trubek*, Toward a Social Theory of Law: An Essay in the Study of Law and Development, 82 Yale L. J. 1, 11 *et seq.* (1972).

162 *Trubek* (supra note 161), 82 Yale L. J. 1, 15 (1972).

163 See *Djankov/Glaeser/La Porta/Lopez-de-Silanes/Shleifer* (supra note 156), 31 J. Comp. Econ. 595 (2003).

164 *Adam Smith*, cited in: *Rodrik/Subramanian/Trebbi*, Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development, 9 J. Econ. Growth 131 (2004). See also *North/Weingast*, Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England, 49 J. Econ. Hist. 803 (1989); *De Long/Shleifer*, Princes and Merchants: European City Growth Before the Industrial Revolution, 36 J. Law Econ. 671 (1993).

165 *Hayek*, The Road To Serfdom, p. 72 (1944).

market economies are based on the initiatives and decision-making of individuals who, in order to be able to plan their economic efforts, require governmental actions to be restricted according to rules "made in advance, in the shape of formal rules which do not aim at the wants and needs of particular people [, but] are intended to be merely instrumental in the pursuit of people's various individual ends."[166]

While the function of legal institutions was initially mainly of interest in explaining the economic development of industrialized nations and was debated in the ideological conflict between liberalism and socialism, lawyers and social scientists took interest in institutional economics after decolonization gained momentum after World War II in order to explain and remedy the economic weaknesses of many developing countries. In this context, the "law and development" movement focussed on the function of law in the Third World and its possible impact on sustainable economic growth.[167] In its core conception, the movement viewed "modern law […] as a functional prerequisite of an industrial economy", because it promoted the development of markets or, in a more state-centered view, enabled the state to use law as a tool to guide economic activity.[168] Notably, the concept of the rule of law figured prominently in the movement's theoretic framework.[169]

More recently, the linkage between institutions, growth and development is analyzed by new institutional economics. Scholars in this field particularly emphasize the significance of a well-functioning legal system that embodies the rule of law for economic growth and development. *Posner*, for instance, points to the "empirical evidence showing that the rule of law does contribute to a nation's wealth and its

166 *Hayek* (supra note 165), p. 73.

167 See for an overview of the law and development movement with further references see *Trubek* (supra note 161), 82 Yale L. J. 1 (1972).

168 *Trubek* (supra note 161), 82 Yale L. J. 1, 6 *et seq.* (1972).

169 See *Trubek/Galanter*, Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States, 1974 Wisc. L. Rev. 1062, 1071 (1974); see also *Trubek* (supra note 161), 82 Yale L. J. 1, 6 *et seq.* (1972) with further references. Although the scholarly endeavors of the law and development movement ended quickly in the United States because the perspective it assumed was criticized as centered on Western thought and little receptive to the needs and traditions of third world countries, its legacy continued in other countries and was also influential with respect to the development efforts of international organisations within the United Nations system. For an overview of the history of the law and development movement see *Tamanaha*, The Lessons of Law-and-Development Studies, 89 A.J.I.L. 470, 472 *et seq.* (1995).

rate of economic growth."[170] This evidence is also buttressed by various theoretic economic analyses.[171]

The findings of new institutional economics have also been at the core of the development strategy of the World Bank. The linkage between the rule of law and economic development has, in particular, materialized in the Bank's legal reform program.[172] It has also been reiterated in the World Bank's good governance agenda, which comprises, as one of the core concepts that help to establish good government in developing countries, the rule of law. In its 1992 report on *Governance and Development* the Bank stated, although not in respect of foreign investment, that

"[the] connection of the rule of law with efficient use of resources and productive investment, which must be understood and dealt with in highly specific and differentiated cultural and political settings, is the aspect most important to economic development, and hence to World Bank assistance."[173]

While the economic literature consistently points to parallels and interdependencies between economic development and the emergence of stable and reliable institutions, the nature of the relationship between institutions and economic growth is debated, in particular whether, and if so to what extent, a causal relationship be-

170 *Posner*, Creating a Legal Framework for Economic Development, 13 The World Bank Research Observer 1, 3 (1998). For empirical analyses see *De Soto*, The Other Path (1989); *De Long/Shleifer* (supra note 164), 36 J. Law Econ. 671 (1993); *Besley*, Property Rights and Investment Incentives: Theory and Evidence from Ghana, 103 J. Pol. Econ. 903 (1995); *Easterly/Levine*, Africa's Growth Tragedy: Policies and Ethnic Divisions, 112 Q. J. Econ. 1203 (1997); *Easterly/Levine*, Tropics, Germs, and Crops: How Endowments Influence Economic Development, 50 J. Mon. Econ. 3 (2003); *Knack/Keefer*, Institutions and Economic Performance: Cross Country Tests Using Alternative Institutional Measures, 7 Econ. & Pol. 207 (1995); *Acemoglu/Johnson/Robinson*, The Colonial Origins of Comparative Development: An Empirical Investigation, 91 Am. Econ. Rev. 1369 (2001); *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004).

171 For analyses in institutional economics see *Hayek*, The Constitution of Liberty (1960); *Olson*, The Logic of Collective Action (1965); *Olson*, Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships (2000); *Demsetz*, Towards a Theory of Property Rights, 57 Am. Econ. Rev. 347 (1967); *North*, Structure and Change in Economic History, p. 201 *et seq.* (1981); *North* (supra note 154), p. 3 (1990); *Posner*, Equality, Wealth, and Political Stability, 13 J. L. Econ. & Org. 344 (1997), *Barro*, Economic Growth in a Cross Section of Countries, 106 Quart. J Econ. 407 (1991), *Scully*, The Institutional Framework and Economic Development, 96 J. Pol. Econ. 652 (1988).

172 See for an analysis of the economic underpinnings and the development strategy of the World Bank's law reform program from a critical perspective *Tshuma*, The Political Economy of the World Bank's Legal Framework for Economic Development, 8 Soc. & L. Stud. 75 (1999).

173 *World Bank*, *Governance and Development*, p. 28 (1992). The concept of the rule of law that the World Bank endorsed is a primarily procedural understanding that comprises five elements that are considered to be conducive to good governance and hence economic development. *Ibid.*, p. 30 (1992): "(a) there is a set of rules known in advance, (b) the rules are actually in force, (c) there are mechanisms ensuring application of the rules, (d) conflicts are resolved through binding decisions of an independent judicial body, and (e) there are procedures for amending the rules when they no longer serve their purpose".

tween institutions and growth exists.[174] From this perspective it is unclear whether the development of legal institutions, including the rule of law, will result in economic growth or whether, in turn, legal institutions are a result of prior economic development and the pressure exercised by the respective interests of economic actors. Yet, even if institutions do not trump all other factors in the quest for economic growth,[175] they nevertheless constitute one important factor for growth and development. In addition, the debate about a causal relationship between institutions and growth seems to be mitigated in the context of foreign investment by the fact that a certain institutional infrastructure that reduces the investment risk is necessary to attract foreign investment. Therefore the critique concerning the causality between institutions and growth seems to be less convincing than in a setting where growth is to be based solely on internal and self-induced economic activity.

Although the rule of law is surely not the only variable that influences economic growth,[176] institutional economics show the importance of the concept for growth and development. Consequently, it seems appropriate to draw a connection between the economic analysis of institutional economics, in particular its emphasis on the impact of the rule of law both on the microeconomics of foreign investors and its macroeconomic implications, and the normative framework of international investment treaties.[177] This gives a normative foundation for interpreting fair and equitable treatment as an embodiment of the concept of the rule of law since states presumably intended to establish institutions that effectively contribute to the object and purpose of international investment treaties and thus to growth and development.

174 See, for example, *Glaeser/La Porta/Shleifer* (supra note 155), 9 J. Econ. Growth 271 (2004) (denying a causal relationship and emphasizing the importance of human capital). *Easterly/Levine* (supra note 170), 50 J. Mon. Econ. 3 (2003) (emphasizing the importance of geography as the decisive factor for economic growth in developing countries). Arguing instead for a positive causal relationship see, for example, *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004), *Acemoglu/Johnson/Robinson*, (supra note 170), 91 Am. Econ. Rev. 1369, 1395 (2001).

175 In this sense *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004).

176 See *North*, Economic Performance Through Time, 84 Am. Econ. Rev. 359, 366 (1994): "[…] transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance."

177 See also *Schneiderman*, Investment Rules and the Rule of Law, 8 Constellations 521 *et seq.* (2001) (arguing that "[t]he investment rules regime is intended to protect established investments abroad far into the future by locking countries into predictable regulatory frameworks. The objective is to bind states to a version of economic liberalism, to impose the discipline of the 'rule of law' on state regulation of the market; domestic rules are thereby rendered predictable and certain.").

E. Conclusion

Fair and equitable treatment has become one of the standard guarantees of protection in international investment treaties and is regularly applied by investment tribunals as a basis for ordering host states to pay damages to foreign investors. The scope given to it in recent investment arbitration is increasingly wide, covering restrictions of domestic courts, domestic administrative bodies and even the national legislator. This transforms fair and equitable treatment into a quasi-constitutional concept that overarches the activity of states vis-à-vis foreign investors. At the same time, arbitral tribunals and scholars in the field of investment protection and public international law frequently note the amorphous structure, the lack of a definition and, in more general terms, the lack of a conceptual understanding of the normative content of this wide-spread treaty standard.

The vagueness of the fair and equitable treatment standard constitutes structural problems for the principle's interpretation and construction by arbitral tribunals. While the arbitral jurisprudence continuously develops a more precise meaning of fair and equitable treatment, it nevertheless meanders around without any clear conceptual vision of the principle's function. The reasoning in arbitral awards is therefore often weak or even unconvincing in its legal analysis. It regularly restricts itself to invoking equally weakly reasoned precedent or refers in an inconclusive manner to the object and purpose of BITs without any deeper justification of how the specific construction contributes to the treaties' objective. Ultimately, these shortcomings endanger the suitability of fair and equitable treatment as a concept against which the conduct of host states can be measured. The main concern in this context is that the jurisprudence does not produce predictable results that are accepted by states but endorse an approach that allows for a broad *ex post facto* control of host state conduct. Predictability in its application is, however, essential for host states and foreign investors alike who need to know beforehand what kind of measures entail the international responsibility of the state and, accordingly, against which kind of political risk fair and equitable treatment protects.

In order to grasp the normative content of fair and equitable treatment, this article submitted that the standard can be understood as an embodiment of the rule of law. The survey of investment decision shows that the concept underlying fair and equitable treatment is functionally equivalent to the understanding of the requirements deduced from the rule of law under domestic legal systems and other international law regimes. Investment tribunals have thus interpreted fair and equitable treatment so as to encompass sub-elements the rule of law is associated with in various domestic legal systems. In this respect, the jurisprudence of arbitral tribunals concerning fair and equitable treatment can be analyzed as including (1) the requirement of stability and predictability of the legal framework and consistency in the host state's decision-making, (2) the principle of legality, (3) the protection of investor confidence or legitimate expectations, (4) procedural due process and denial of justice, (5) protection against discrimination and arbitrariness, (6) the requirement of transparency and (7) the concept of reasonableness and proportionality.

In its core, the rule of law understanding underlying the jurisprudence of investment tribunals can be described as primarily procedural and institutional in nature. Accordingly, the control exercised by investment tribunals over the conduct of host states is mainly concerned with the institutional structure and the procedural implementation of law and policy which affect foreign investors. Fair and equitable treatment, for example, requires the existence of a minimal separation of powers in host states, the possibility of recourse to courts for the adjudication of private rights and the review of acts of public authorities, legal security, protection of legitimate expectations and the observance of procedural rights in administrative and judicial proceedings.

At the same time, such a procedural and institutional understanding of the rule of law allows states sufficient leeway in implementing their own substantive policy choices and in reacting to newly emerging circumstances, including state emergencies. Fair and equitable treatment does, however, not only influence the way host states change their regulatory frameworks after an investment was made,[178] but in a more comprehensive way requires them to adapt their domestic legal orders to standards that are internationally accepted as conforming to the concept of the rule of law. While, the paper only aimed at outlining the general features of a rule of law understanding of fair and equitable treatment and tried to explain the concept and function of this widely used treaty standard, the exact contours of the various subelement still require further elaboration and context-specific analyses.

Arguably, such an understanding of fair and equitable treatment can be supported by an economic analysis of international investment treaties. This is particularly true considering the object and purpose of investment treaties that aim at protecting and promoting foreign investment flows and ultimately economic growth and development. This purposive link between the protection standards contained in the treaties and the promotion of investment justifies drawing a parallel to the economic literature that expands on the relationship between the rule of law and economic growth. The positive economic impacts that are linked to the rule of law and the incentive structure necessary for foreign investors to invest in a specific country suggest such an understanding of fair and equitable treatment as appropriate in the context of investment treaties. This can be buttressed by the assumption that states intended to have the most efficient structures implemented in order to promote investment flows. Finally, the paper suggests that tribunals should draw – in a comparative approach – on the jurisprudence of domestic and international courts on rule of law standards in order to further concretize fair and equitable treatment. This would help to convincingly justify and apply fair and equitable treatment in various context-specific fields of economic activity and state regulation. At the same time, the reference to rule of law concepts under domestic legal orders also illustrates that the rule of law is not an absolute guarantee but rather allows for a balance between the interests of host states and foreign investors. In this context, one should keep in

178 In this sense *Dolzer* (supra note 8), 39 Int'l Law. 87, 100 *et seq.* (2005).

mind the words of *Joseph Raz* who concluded his seminal article on the *The Rule of Law and its Virtue* by recalling:

"After all the rule of law is meant to enable the law to promote social good, and should not be lightly used to show that it should not do so. Sacrificing too many social goals on the altar of the rule of law may make the law barren and empty."[179]

179 *Raz* (supra note 39), 93 L. Quart. Rev. 195, 211 (1977).

"Expropriation" and "Fair and Equitable Treatment" Standards in Recent ICSID Jurisprudence

Comment by *Jo Delaney*[*]

Thank you to Professor *Hofmann* and the organisers for their kind invitation and giving me, a younger practitioner, an opportunity to present.

Mr *Schill's* comprehensive analysis of the standards of expropriation and fair and equitable treatment raises many thought provoking questions.

I want to focus on the interrelationship between the two standards in the 10 minutes I have. As Mr *Schill* has referred to in his analysis, the trend in recent investment cases, ICSID and non-ICSID, raises questions about the role of the legitimate expectations of the investor and how such expectations connect these two standards. First, I want to briefly address the increasing emphasis on legitimate expectations as an essential element of fair and equitable treatment. Then, I will look at the role of the investor's expectations in determining whether there has been an expropriation, particularly a "regulatory taking", which is itself a growing concept.

A. Legitimate Expectations - Fair and Equitable Treatment

The focus on the legitimate expectations of the investor has widened the standard of "fair and equitable" treatment beyond the minimum standard for aliens in customary international law. Recent cases have emphasised that fair and equitable treatment not only requires the State not to act in an unreasonable or arbitrary manner or to ensure good faith or due process, but it also now requires that the State consider and act consistently with the legitimate expectations of the investor.

The respect for the investor's "legitimate expectations" was explained in detail in paragraph 154 of the Tribunal's Award in the *Tecmed* case. I won't read out the paragraph as it is very long but the Tribunal referred to the need for the State to act consistently, "free from ambiguity and totally transparently", not only in relation to regulations but the goals of regulations so the investor can plan its investment and comply with the necessary regulations. The Tribunal emphasised that consistency requires the State not to arbitrarily revoke any pre-existing decisions or permits which the investor has relied upon and to act in conformity with any regulations.

This approach has been adopted in subsequent cases which have also been analyzed by Mr *Schill*:

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- *MTD v Chile (ICSID)* where the Tribunal found that it was unfair that the State (acting through one body) approved an investment and entered into a foreign investment contract when the investment was against the policy of the State itself in that the State would not change a zoning permit in order to grant the necessary permits for the investment.
- *Occidental Petroleum v Ecuador (UNCITRAL)* - where the Tribunal found that the State had acted without clarity and inconsistently in relation to the tax change and its practice and regulations in relation to VAT refunds. The investor had entered into participation contracts for the exploration and production of oil and had been able to claim VAT refunds but in 2001 there was a change in tax policy by the SRI (tax authority) and subsequent VAT refunds were denied.
- *CMS v Argentina (ICSID)* - where the Tribunal found that the State had not provided a stable legal and business environment as required as an essential element of fair and equitable treatment, these guarantees being crucial for the investor's investment decision]

Most recently, it was considered by the NAFTA Tribunal in *Thunderbird Gaming Corporation v Mexico* (UNCITRAL), the ad hoc Tribunal in *Eureko v Poland* and the UNCITRAL Tribunal in *Saluka Investments BV v Czech Republic* (otherwise referred to as *Nomura* case).

While *Saluka* was not an ICSID case but under the UNCITRAL Rules, the Tribunal's comments are still instructive to future ICSID Tribunals. The Tribunal in that case emphasised that "legitimate expectations" was the "dominant element" of the fair and equitable standard. The investor's expectations included the State's observation of "good faith, due process and non-discrimination" (para 303). The Tribunal stressed that such expectations must be legitimate and reasonable "in light of the circumstances" (para 304).

The Tribunal held that the Czech Republic undertook an obligation not to frustrate the legitimate and reasonable expectations of the investor (para 302) and found that the Czech Republic had breached the investor's legitimate expectations such that it had treated the investor unfairly and inequitably. It is how the Tribunal found this breach, while also holding that its conduct did not amount to expropriation because of the State's right to regulate that I want to focus on but first I will address the role of legitimate expectations in expropriation.

Similarly in *Thunderbird Gaming Corporation v Mexico*, the NAFTA Tribunal held that if the State's conduct creates legitimate expectations and the investor acts in reliance on that conduct, the State must honour those expectations if a failure to do so would cause damage to the investor (para 147).

Professor *Thomas Walde* expanded upon this concept in his Separate Opinion, emphasising that the expectation must be "legitimate" through some official conduct and that the investor must have relied upon that conduct to its detriment (para 1, 21, 119).There must be reasonable detrimental reliance if the investor is to be entitled to compensation.

B. Legitimate Expectations - Expropriation

The investor's legitimate expectation is often the starting point for a tribunal's analysis of whether there has been an expropriation of the investment.

For example, in *Metalclad*, the Tribunal looked to whether the investor had been deprived "in whole or in significant part, of the use or reasonably-to-be expected economic benefit of the property" (para 103).

In *Tecmed*, the Tribunal looked at the investor's expectations of its return on the investment, particularly since it was a long term investment that required time to establish the business and recover the investment and obtain an expected return. In determining whether there had been an expropriation of the investment, the Tribunal analysed (1) the reasonable expectations of the investor for a return; (2) whether the State had failed to protect the investor's rights when the State was confronted with social opposition; and (3) whether the measures taken were proportionate to the investor's expectations or excessive in light of the social protests.

In both of these cases, the Tribunals found that the State had deprived the investor of its legitimate expectations to a return or economic benefit and thus had expropriated the investment. They also found a breach of fair and equitable treatment.

However, in some cases, even though the Tribunal found that the State acted inconsistently with the investor's legitimate expectations and found a breach of the fair and equitable treatment standard, it did not found that the State's conduct amounted to an expropriation of the investment. There is not necessarily any inconsistency between these two findings but there may be where the alleged expropriation is found to be a legitimate regulation.

For example, in *CMS*, the Tribunal found that the State failed to provide a stable legal and business environment due to the uncertainty of the period from 2000 to 2002 and the final determinations under the Emergency Law, thereby in breach of the fair and equitable treatment standard. However, it did not find an expropriation as (1) *CMS* retained full ownership and remained in control of the investment; and (2) the Government had not managed the day-to-day operations of the company. In this case, the Tribunal focused on the investor's continuing ownership, management and control rather than whether Argentina's regulatory measures were legitimate.

But what if the investor does lose its investment, as in the *Saluka* case? Can a regulation that is said to be legitimate also be consistent with the legitimate expectations of the investor? What if the carrying out of that regulation by the State is inconsistent with investor's expectations? How is the State's legitimate regulation to be balanced against the investor's legitimate expectations?

The *Saluka* case raises questions about the interrelationship between an investor's legitimate expectations in the context of fair and equitable treatment on the one hand, and expropriation, on the other. The alleged expropriation in this case was a "regulatory taking". The Tribunal found that the State's regulatory actions were justified: i.e. that the Czech National Bank was justified in imposing the forced administration on the bank and appointing an administrator, particularly since the

decision had been confirmed by the CNB Appellate Board and upheld by the Prague City Court twice.

Yet the Tribunal also found that the State had acted unfairly and inequitably, contrary to *Saluka/Nomura's* legitimate expectations:

- (1) The State had failed to provide financial assistance to IPB for the bad debt problem when it had provided that assistance to three of the Big Four banks. The Tribunal recognised that this failure was discriminatory and created an environment which made it impossible for the IPB to survive. *Saluka* was justified in expecting to be treated in an even-handed and reasonable manner.
- (2) The State had also failed to take seriously *Saluka's* proposals to solve the problem and deal with it in an objective, transparent, unbiased and even-handed way. The State had failed to address *Saluka's* proposal and had unreasonably refused to communicate with IPB and *Saluka/Nomura* in an adequate manner.

What is difficult to digest with this case is that it was the CR's conduct in relation to its failure to provide financial assistance and its failure to consider Nomura's proposals, these both being contrary to *Saluka/Nomura's* legitimate expectations, which led to the factual circumstances that resulted in the Czech National Bank having to take the decision to place IPB in forced administration leading to the alleged expropriation. If *Saluka/Nomura's* legitimate expectations had been fulfilled, then the forced administration may not have been necessary. Yet the Tribunal found that the forced administration was a justifiable regulatory step that did not amount to expropriation.

Other tribunals analysing alleged regulatory takings have taken a different approach, e. g. in the *Feldman* case, where the Tribunal acknowledged that not all regulatory measures amount to an expropriation.

In *Tecmed*, which Mr *Schill* also referred to, the Tribunal emphasised that measures, whether or not they were regulatory, amounted to an indirect expropriation if they were "irreversible and permanent" and the "economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed" (para 116). The Tribunal emphasised that it was the effect of the measures, not the intent that was important. The Tribunal also looked to whether the measures were proportionate to the public interest they intended to protect and found that in that case they were disproportionate.

Beyond looking at the proportionality of the measures, the Tribunal did not offer any assistance in determining when a legitimate regulatory measure crosses the line and amounts to a regulatory taking or expropriation. However, would the proportionality test have assisted the Tribunal in *Saluka*?

The UNICTRAL Tribunal in *Saluka* acknowledged that the threshold for regulatory takings has not yet been defined, but did not offer any suggestions as to what would be appropriate criteria in determining that threshold, other than referring to the *Harvard Draft Convention* of the 1960s which recognised that *bona-fide* non-discriminatory regulation was not expropriation and set out 4 exceptions, which I

will not go into due to time. In the context of analysing the fair and equitable treatment standard, the Tribunal focused on the expectations of the investor and the need to balance those expectations with the State's legitimate regulatory interests (para 305-6). But it did not do so in the context of the expropriation claim. If it did, perhaps it would have reached a different conclusion. Or if the Tribunal had analysed whether the decision of forced administration was proportionate to *Saluka's* legitimate expectations, it may have reached a different conclusion.

C. Conclusion

Accordingly, it appears that we must be content with the vague indications given by investment tribunals to date on the role of legitimate expectations in the analysis of these two standards:

- Legitimate expectations of the investor is an essential element of the fair and equitable treatment standard;
- It may be the starting point for an analysis of an expropriation claim;
- The investor's legitimate expectations may need to be balanced against the legitimate regulatory interests of the State if regulatory measures have allegedly led to an expropriation;
- However, how are these expectations and regulatory interests to be balanced?
- Is it sufficient to consider whether the regulatory measures are proportionate to the investor's expectations?

Hopefully, we will all have an opportunity to encourage future Tribunals to provide some guidance to these questions, preferably within the next 4-5 years rather than the next 40 years.

"Fair and Equitable Treatment" – Determining Compensation

Comment by *Kaj Hobér*[*]

A. Introduction

Fair and equitable treatment is one of the standards of treatment of foreigners under international law. One of the early sources for a discussion of the treatment of foreigners is the *Neer Case*.[1] The concept of fair and equitable treatment did not exist at that time, but the case does address in general terms treatment of foreigners by a host State.

In the post Second World War attempts to regulate the international economy – resulting in the establishment of the World Bank and the International Monetary Fund – the negotiating states also tried to create a world trade organization, later referred to as the International Trade Organization. In the 1948 Havana Charter for the International Trade Organisation it was stated in Article 11(2)[2] that the International Trade Organisation could make recommendations and promote bilateral or multilateral agreements on measures designed *"to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another"*. In the same year the Ninth International Conference of American States adopted the Economic Agreement of Bogotá under which foreign capital were to receive "equitable treatment" [3] (Article 22). However, neither the Havana Charter, nor the Agreement of Bogotá came into force. In the 1950's refer-

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1 *Neer v. Mexico*, Opinion, United States – Mexico General Claims Commission, 15 October 1926 21 American Journal of International Law (1927) 555.

2 Article 11(2) of the Havana Charter reads as follows: "The Organization may, in such collaboration with other inter-governmental organizations as may be appropriate:
(a) make recommendations for and promote bilateral or multilateral agreements on measures designed.
(i) to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another;
(ii) to avoid international double taxation in order to stimulate foreign private investments;
(iii) to enlarge to the greatest possible extent the benefits to Members from the fulfilment of the obligations under this Article;
(b) make recommendations and promote agreements designed to facilitate an equitable distribution of skills, arts, technology, materials and equipment, with due regard to the needs of all Members;
(c) formulate and promote the adoption of a general and treatment of foreign investment."

3 "Los capitales extranjeros recibirán tratamiento equitativo".

ences to fair and equitable treatment started to appear in the US Treaties on Friendship, Commerce and Navigation.[4]

As noted by *Stephan Schill* in his article "*'Fair and Equitable Treatment' as an Embodiment of the Rule of Law*", arbitral tribunals have struggled, and continue to struggle, with a definition of the rather vague concept of fair and equitable treatment, and have, so far, been unable to develop a uniform methodology for determining when a violation of fair and equitable treatment has occurred.[5]

These difficulties do not come as a surprise. The standard of fair and equitable treatment is relatively imprecise and is very much dependent on the specific circumstances of the individual case. The principle can thus not be applied in the abstract. The standard of fair and equitable treatment is a broad principle of international law which must, like other such principles, be specified, refined and supplemented by decisions of international tribunals. In fact this is the only realistic approach, since it would be virtually impossible to anticipate and specify in detail host State conduct that should be covered by this principle.

The aforementioned lack of precision notwithstanding, *Stephan Schill* has identified seven normative elements forming part of the reasoning of arbitral tribunals when analysing the principle of fair and equitable treatment, *viz.,* (i) the requirement of stability, predictability and consistency of the legal framework, (ii) the principle of legality, (iii) the protection of investor confidence or legitimate expectations, (iv) procedural due process and denial of justice, (v) substantive due process or protection against discrimination and arbitrariness, (vi) the requirement of transparency and (vii) the requirement of reasonableness and proportionality.[6]

The purpose of this contribution is to address another aspect of fair and equitable treatment, *viz.*, to analyze arbitral practice with the aim of identifying principles, if any, for the *determination of the compensation* for violation, once established, of the fair and equitable treatment standard.

B. Compensation for Violation of the Fair and Equitable Treatment Standard

I. Introduction

Almost all recent Bilateral Investment Protection Treaties (BIT:s) require that investors covered by the treaty in question receive fair and equitable treatment. This principle is also enshrined in the North American Free Trade Agreement (NAFTA)[7] as

4 See further Fair and Equitable Treatment Standard in International Investment Law, OECD Working Papers on International Investment No. 2004/3, p. 3-4.

5 See *Schill*, p. 35-36.

6 *Schill*, p. 41-42.

7 Article 1105(1) of NAFTA reads as follows: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security".

well as in the Energy Charter Treaty (ECT)[8]. In none of these treaties, however, is there any provision, nor language, addressing the issue of compensation in case of violation of the fair and equitable treatment standard. The situation is of course different with respect to expropriation. Most investment protection treaties, bilateral as well as multilateral, have provisions addressing compensation in case of expropriation.

II. The Legal Basis for Compensation

The determination of compensation for violations of the fair and equitable treatment standard is, however, not made in a legal vacuum. The legal basis is found in customary international law. Article 31 of the International Law Commission's (ILC) Articles on State Responsibility reads as follows:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of State.

The principles expressed in this Article are generally held to represent generally accepted customary international law. These principles were formulated already by the Permanent Court of International Justice in the *Chorzow Factory* case.

The Court said:

> "It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form. Reparation therefore is the indispensable complement to a failure to apply a convention and there is no necessity for this to be stated in the convention itself. Differences relating to reparations, which may be due by reason of failure to apply a convention, are consequently differences relating to its application".[9]

8 Article 10(1) of the ECT reads as follows "Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment […]".

9 *Factory at Chorzów*, 1927, P.C.I.J., Series A, No. 9, p. 2.

Under the *Chorzów Factory* case, the State violating international law is liable to provide full compensation, *i.e.* to re-establish the situation, which would have existed had that violation not occurred:

> "The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, so far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."[10]

Article 34 of the ILC Articles then goes on to describe the different forms of reparation. They include restitution, compensation and satisfaction.

Even though the primary form of reparation under the ILC Articles is restitution, from an investment dispute point of view, the practically relevant form is compensation, which is regulated in Article 36. It reads:

> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profit insofar as it is established.

In the context of compensation for violations of the fair and equitable standard, suffice it to make two comments at this stage.

First, Article 31 refers to "full reparation". This means, in the words of the Chorzow Factory case "to wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed".[11] This principle has been extensively discussed with respect to calculation of compensation for expropriation. Difficult as it may be to apply this principle to expropriation, it is at least arguable that this is easier than to apply the principle to compensation for violations of the fair and equitable standard. The typical situation

10 *Factory at Chorzów*, 1928, P.C.I.J., Series A, No. 17, p. 47.
11 See note 10, *supra*

with respect to an expropriation is that it puts an end to the investment in question. Violations of the fair and equitable standard do not necessarily lead to this result, but the investment, e.g. a business activity, may well continue. The difficulty then is to determine what "full reparation" means in this context.
The foregoing leads to the *second* observation. It is clear from the language used in Articles 31, 34 and 36 that there must be a causal link between the injury and the internationally wrongful act. The provisions all refer to the "*injury caused by the internationally wrongful act*". In the context of fair and equitable treatment, it is not difficult to envisage situations where it must be very complicated to determine the extent to which an injury has been caused by a violation of this standard and not by any other event.

C. Decisions by Arbitral Tribunals

I. Introduction

There are few recent decisions by arbitral tribunals in investment disputes, which deal with compensation for violations of the fair and equitable standard as a discrete and separate matter. This is perhaps not very surprising since many, if not most, investment disputes primarily focus on expropriation. Questions of fair and equitable treatment then tend to play a secondary role, and are not given separate treatment. There are three recent ICSID cases which address the issue of compensation for violations of the fair and equitable treatment standard as a separate matter. The only two cases decided so far on the merits under the ECT also deal with these issues, as do at least three NAFTA cases. These cases will be discussed in the following.

II. ICSID cases

1. MTD v. Chile

In *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*[12]*, MTD* (Malaysia) had invested in Chile by participating in a joint venture which planned to buy land for the purpose of constructing a mixed use upscale community. The investment was made through a local company, *MTD* Chile, which in turn invested in and owned 51 percent of the joint venture company, El Principal, which was to own the land and develop the project. The investment was approved by the Foreign Investment Commission (FIC) and a foreign investment contract was signed. An addi-

12 ICSID Case No. ARB/01/7, Award of 25 May 2004.

tional capital contribution by *MTD* was subsequently approved by the FIC. Thereafter the project ran into difficulties resulting from the absence of a change of zoning legislation for the use of land. In the end the project was not approved by the authorities.

The applicable Malaysia-Chile BIT contained an MFN-clause, which in the view of the Tribunal made substantive protection standards of other Chilean BITs applicable as argued by the Claimants.

In the arbitration the Claimants alleged that the Respondent had breached:

(i) Articles 2(2) and 3(1) of the BIT and Article 4(1) of the Croatia BIT by treating their investment unfairly and inequitably;
(ii) Article 3(1) of the Denmark BIT by breaching the Respondent's obligations under the Foreign Investment Contracts;
(iii) Article 3(2) and (4) of the Croatia BIT by impairing through unreasonable and discriminatory measures the use and enjoyment of the Claimants' investment and by failing to grant the necessary permits to carry out an investment already authorized; and
(iv) Article 4 of the BIT by expropriating their investment.

In essence the issues under dispute were the following: what was the significance to be attached to the approvals of the FIC and the execution of the Foreign Investment Contracts (*i.e.* creating legitimate expectations that the project would be granted necessary approvals or a mere decision on the legality of inflow of foreign capital), whether *MTD* had been warned of the risks relating to the zoning change, whether *MTD* otherwise had exercised due diligence in making its investment.

Article 2(2) of the applicable BIT required that *"Investments of investors of either Contracting Party shall at all time be accorded fair and equitable treatment*". The Croatia BIT provided further that the right to fair and equitable treatment shall *"not be hindered in practice"* (Article 4(1)).

The Tribunal noted that being a Tribunal established under the BIT, it was obliged to apply the provisions of the BIT and interpret them in accordance with the norms of interpretation established by the Vienna Convention on the Law of the Treaties, which is binding on the State parties to the BIT. Article 31(1) of the Vienna Convention requires that a treaty be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The Tribunal found that in their ordinary meaning, the terms "fair" and "equitable" used in Article 3(1) of the BIT mean "just", "even-handed", "unbiased", "legitimate". As regards the object and purpose of the BIT, the Tribunal referred to its Preamble where the parties state their desire "to create favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party", and the recognition of "the need to protect investments by investors of both Contracting Parties and to stimulate the flow of investments and individual

business initiative with a view to the economic prosperity of both Contracting Parties". Hence, in terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a pro-active statement –"to promote", "to create", "to stimulate"- rather than prescriptions for a passive behaviour of the State or avoidance of prejudicial conduct to the investors.

The Tribunal also adopted as its standard the standard suggested by the Tribunal in the *TECMED S.A. v. The United Mexican States* case:

> "to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation".[13]

Taking account of, *inter alia*, the ministerial membership of the FIC, the duty of Chilean state organs to act coherently and to apply its policies consistently, and of the fact that the State under international law is to be considered as a unit, the Tribunal was satisfied, based on the evidence presented to it, that approval of an investment by the FIC for a project that was against the urban policy of the Government, amounted to a breach of the obligation to treat an investor fairly and equitably.

As regards compensation the Tribunal noted that the BIT provided for "prompt, adequate and effective" compensation for expropriation. However, the BIT did not provide for any standard for compensation for breaches of the BIT on other grounds, including fair and equitable treatment. As a starting point, the Tribunal used the standard pronounced by the Permanent Court of Justice in the *Chorzów Factory*

13 *Técnicas Medioambientales TECMED S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)00/2, award dated May 29, 2003, para. 154.

case*, viz.,* that the compensation should *"wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed"*.[14]

Based on this principle the Tribunal concluded that the expenditures relating to Claimant's investment in Chile, which were eligible for purposes of the calculation of damages amounted to approximately US$ 21.5 million. Such expenditures could have been avoided, had there been no breach of the fair and equitable treatment standard.

The Tribunal also underlined, however, that Chile was not responsible for the consequences of unwise business decisions or for the lack of diligence of the investor. Its responsibility was limited to the consequences of its own actions to the extent they breached the obligation to treat the Claimants fairly and equitably. In this respect the Tribunal observed, *inter alia,* that no specialist on urban development had been contacted by the Claimants until the deal was closed, that the Claimants apparently did not appreciate the fact that their JV-partner may have had a conflict of interest with the Claimants, that they seemed to have accepted his judgment, that MTD was in a hurry to start the Project, that BITs are not an insurance against business risks, and that the Claimants, as experienced businessmen, must bear the consequences of their own actions. Their choice of partner, the acceptance of a land valuation based on future assumptions without protecting themselves contractually in case the assumptions would not materialize, including the issuance of the required development permits, were risks that the Claimants took irrespective of Chile's actions. Therefore, the Tribunal awarded only 50 per cent of eligible expenditures resulting from the fact that the zoning legislation was not changed.

The starting point for the Tribunal was thus the concept of "full reparation" as laid down in the *Chorzow Factory* case and in the ILC Articles On State Responsibility. The more interesting aspect of the Tribunal's reasoning is the fact that it reduced the amount eligible for compensation by 50 per cent. The percentage as such would seem to be the result of the Tribunal exercising its discretion in determining the amount of compensation. The justification for the reduction could be explained in either of the following ways. *First*, it is possible that the Tribunal took the view that the Claimants had not established a causal link between the violation of the fair and equitable treatment standard going beyond 50 per cent of the expenditures. Put differently: part of the injury was the result of Claimants' own doing. In the view of the Tribunal, the Claimants had not in all respects acted as a prudent investor. The consequences of such conduct had to be borne by the Claimants themselves.

Second, an alternative explanation – but to a large extent, the other side of the same coin – would be to view Claimants' conduct as a case of contributory negligence. In other words, the Claimants themselves had contributed to their own misfortune. To the extent that this was the case, the host state could not be held responsible.

14 See note 10, supra.

2. CMS v. Argentine

The second ICSID case is *CMS Gas Transmission Company v. The Argentine Republic*[15] In this case the Argentinean company TGN had been granted a license for the transportation of gas. Investors had been invited to invest in the shares of *TGN*. The American company *CMS* acquired 29.42 per cent of the shares.

Under the arrangements made for the privatization of this sector of the Argentinean economy, tariffs were to be calculated in US dollars and expressed in pesos at the exchange rate at the time of billing. They were also to be adjusted semi-annually in accordance with the United States Producer Price Index (the "US PPI"). Following the major economic and financial crisis in the country, the Republic of Argentina enacted, starting late 1999, various measures which had, in the Claimant's view, an adverse impact on its business and breached the guarantees (*i.e.* the legal regime created by the gas legislation and regulations as well as the terms of the license) which were intended to protect its investment in *TGN*. These measures later led to the devaluation of the peso and the adoption of additional financial and administrative measures also alleged to have had an adverse impact on the investor.

The Claimant was of the view that the measures adopted by the Argentine Government were in violation of the commitments that the Government made to foreign investors in the offering memoranda, relevant laws and regulations and the license itself. Such commitments, it was asserted, included the calculation of tariffs in US dollars, the semi-annual adjustment in accordance with the US PPI and a general adjustment of tariffs every five years, all with the purpose of maintaining the real dollar value of the tariffs. The Claimant argued that Argentina further agreed expressly not to freeze the tariff structure or subject it to further regulation or price controls; and that in the event that price controls were introduced, *TGN* would be compensated for the difference between the tariff it was entitled to and the tariff actually charged. Moreover, the basic rules governing the license could not be altered without *TGN*'s consent. The Claimant was of the view that these guarantees constituted essential conditions for *CMS*'s investment and that it had an acquired right to the application of the agreed tariff regime.

The Claimant argued, *inter alia,* that Argentina had breached the fair and equitable standard insofar as it had profoundly altered the stability and predictability of the investment environment, an assurance that was key to *CMS'*s decision to invest.

Quoting the preamble of the Argentina – US BIT – that fair and equitable treatment is desirable "*to maintain a stable framework for investments and maximum effective use of economic resources*" – the Tribunal found that a stable legal and business environment was an essential element of fair and equitable treatment. The Tribunal found that the measures complained of did in fact entirely transform and alter the legal and business environment under which the investment was decided and made. The Tribunal further noted that a significant number of treaties show that

15 ICSID Case No. ARB/01/8, Award of 12 May 2005.

fair and equitable treatment was inseparable from stability and predictability and that the law of foreign investment and its protection had been developed to avoid adverse legal effects when specific commitments had been made. The Tribunal also observed that this was an objective requirement unrelated to whether the Respondent had had any deliberate intention or bad faith in adopting the measures in question.

Turning to compensation, the Tribunal initially noted that under international law that are three main forms of reparation for injury: restitution, compensation and satisfaction.[16] It ruled out "satisfaction" since the case was not of reparation due to an injured State. As regards "restitution" the Tribunal noted, by reference to the *Chorzów Factory* case, that this is the standard used to re-establish the situation which existed before the wrongful act was committed, provided that this is not materially impossible and does not result in a burden out of proportion as compared to compensation.[17]

As regards "compensation" the Tribunal stated that it is designed to cover any financial assessable damage including loss of profits insofar as it is established, and that it is only called for when the damage is not made good by restitution.[18] Quoting the decision in the *Lusitania* case[19], the Tribunal held that the remedy should be commensurate with the loss, so that the injured party may be made whole.[20] The Tribunal was thus inclined to award full compensation for a violation of the fair and equitable treatment standard.

However, when discussing the methods to determine and calculate compensation the Tribunal stated that "[d]epending on the circumstances, various methods have been used by tribunals to determine the compensation which should be paid but the general concept upon which commercial valuation of assets is based is that of 'fair market value.'"[21]

The Tribunal continued to say that:

> "Four ways have generally been relied upon to arrive at such value. (1) the 'asset value' or the 'replacement cost' approach which evaluates the assets on the basis of their 'break-up' or their replacement cost; (2) the 'comparable transaction' approach which reviews comparable transactions in similar circumstances; (3) the 'option' approach which studies the alternative uses which could be made of the assets in question, and their costs and benefits; (4) the 'discounted cash flow' ('DCF') approach under which the valuation of the assets is arrived at by determining the present value of fu-

16 The Award, para. 399.
17 The Award, para. 400.
18 The Award, para. 401.
19 *Lusitania*, RIAA, Vol. VII, 1923, p. 32.
20 The Award, para. 401.
21 The Award, para. 402.

> ture predicted cash flows, discounted at a rate which reflects various categories of risk and uncertainty."[22]

Having concluded that reparation by way of restitution was not an alternative for the Tribunal in the present situation, because such restitution would require a settlement between the parties, the Tribunal went on to analyze the issue of compensation.[23] It appears that the path eventually chosen by the Tribunal was the method commonly used when determining compensation for expropriation.

> "[T]he cumulative nature of the breaches discussed here is best dealt with by resorting to the standard of fair market value. While this standard figures prominently in respect of expropriation, it is not excluded that it might also be appropriate for breaches different from expropriation if their effect results in important long-term losses."[24]

The Tribunal had no problem in finding that the standard of compensation to be used was that of the fair market value. Likewise, it did not hesitate to use the discounted cash flow (DCF) method as the most appropriate method to calculate the compensation. The decisive factor in this respect seems to have been that *TGN* was a going concern. *TGN*:s license was valid until 2027. With a view to determining the actual loss of the Claimant resulting from the violation of the fair and equitable treatment standard, the Tribunal had to compare two scenarios. The first scenario involved the evaluation of revenue, cash and profits until 2027 on the assumption that there had been no change in the regulatory environment. The second scenario involved the same evaluation based on the new regulatory framework.[25] The Tribunal's reasoning makes it clear that, in this particular case, it concluded that the fair market value and the DCF methodology was the most appropriate way to determine the actual loss of the Claimant. It may also be noted that all experts consulted in the case agreed with this approach.[26]

3. Azurix Corp v. Argentine

In *Azurix Corp v. The Argentine Republic*[27], decided on 14 July 2006, the *Azurix*-Group of the US (at the time of the investment owned by *Enron)* participted in the privatization of water services in the Province of Buenos Aires (the Province). The investment was carried out through a local Argentinian company, *Azurix* Buenos

22 The Award, para. 403.
23 Cf. Articles 35-36 of ILC's Articles on State Responsibility.
24 The Award, para. 410.
25 See Award, paras. 419, 422.
26 The Award, para. 421.
27 ICSID Case No. ARB/01/12, Award of 14 July 2006.

Aires S.A. (ABA), which was incorporated to act as the concessionaire after the *Azurix*-Group won the bid for the water service concession (the Concession). After ABA had made a so-called Canon Payment of 438,555,554 Argentine Pesos on 30 June 1999, ABA and the Province executed a 30-year concession agreement. The concession was overseen and regulated by a regulatory authority established for the purpose - Organismo Regulador de Aguas Bonaerense ("ORAB").

In the arbitration, the Claimant argued, *inter alia,* that the Respondent had violated its obligation, under the U.S.-Argentina BIT, of fair and equitable treatment. The Claimant stated that such measures consisted of actions and omissions of the Province or its instrumentalities that resulted in the non-application of the tariff regime of the Concession Agreement for political reasons; that the Province did not complete certain works that were to remedy historical problems and were to be transferred to the concessionaire upon completion; that the lack of support for the concession regime prevented ABA from obtaining financing for its operations; that in 2001, the Province denied that the Canon Payment was recoverable through tariffs; and that "*political concerns were always privileged over the financial integrity of the Concession*".[28] As a result ABA had been forced to give notice of termination of the Concession and file for bankruptcy, since it was faced with no hope of recovering its investments in the "*politicized regulatory scheme*".[29]

The Respondent, on the other hand, argued that the dispute was a contractual dispute, and that the difficulties encountered by ABA in the Province were of its own making. In particular, Argentina argued that the case presented by the Claimant was intimately linked to *Enron*'s business practices and its bankruptcy; that the price paid for the Concession was excessive and opportunistic and related to the forthcoming IPO of *Azurix* at the time *Azurix* bid for the Concession and that ABA did not comply with the Concession Agreement.

Article II(2)(a) of the applicable BIT provided that "[i]nvestment shall at all times be accorded fair and equitable treatment,…and shall in no case be accorded treatment less than required by international law".

The Tribunal noted that the BIT is an international treaty that should be interpreted in accordance with the norms of interpretation established by the Vienna Convention, which is binding on the state parties to the BIT.[30] Article 31(1) of the Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".

The Tribunal found that it follows from the ordinary meaning of the terms fair and equitable and the purpose and object of the BIT that fair and equitable should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The text of the BIT reflects a positive

28 The Award, para. 43.
29 The Award, para. 43.
30 The Award, para.. 307.

attitude towards investment with words such as "promote" and "stimulate". Furthermore, the parties to the BIT recognize the role that fair and equitable treatment plays in maintaining "a stable framework for investment and maximum effective use of economic resources".[31]

The Tribunal also found that except for *Genin v. Estonia*,[32] there is a common thread in the recent awards under NAFTA and in *Tecmed v. Mexico,*[33] to the effect that bad faith or malicious intention of the recipient State is not a necessary element in the failure to treat investments fairly and equitably. The Tribunal concurred with the Tribunal in *CMS*, which stated that fair and equitable treatment is an objective standard "unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard."[34]

As to the question whether the standard of fair and equitable treatment had been breached, the Tribunal said that it was:

> "struck by the conduct of the Province after the the Claimant gave notice of termination of the Concession Agreement. ABA had requested to terminate the agreement in agreement with the Province. The Province refused what was a reasonable request in light of the previous behavior of the Province and its agencies. The refusal by the Province to accept that notice of termination and its insistence on terminating it by itself on account of abandonment of the Concession is a clear case of a breach of the fair and equitable treatment standard. It is evident from the facts before this Tribunal that the Concession was not abandoned."[35]

The Tribunal countinued to say that:

> "Although the Tribunal has rejected to a certain extent the interpretations of the Concession Agreement and the Law alleged by the Claimant regarding the RPI and the Canon, it is also clear that the tariff regime was politicized because of concerns with forthcoming elections or because the Concession was awarded by the previous government. The issues of the zoning coefficients and the construction variations are cases in point. It is significant that, once the service was transferred, the new service provider was allowed to raise tariffs reflecting the construction variations.

31 The Award, para. 307.
32 *Genin*, *Eastern Credit Limited*, *Inc. and A.S. Baltoil* v. *Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001.
33 *Técnicas Medioambientales TECMED S.A.* v. *The United Mexican States*, ICSID Case No. ARB(AF)00/2, Award, 29 May 2003.
34 The Award, para. 372.
35 The Award, para. 374.

> Finally, the repeated calls of the Provincial governor and other officials for non-payment of bills by customers verges on bad faith in the case of the Bahía Blanca incident when the Province itself had not completed the works that would have helped to avoid the problem in the first place.
>
> Considered together, these actions reflect a pervasive conduct of the Province in breach of the standard of fair and equitable treatment."[36]

As regards the question whether Argentina in addition to the above had also taken measures that could be considered to be arbitrary and to have impaired "*the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal*"[37] of the investment of *Azurix* in Argentina, the Tribunal found that the actions of the provincial authorities calling for non-payment of bills even before the regulatory authority had made a decision, threatening the members of the ORAB because it had allowed ABA to resume billing, requiring ABA not to apply the new tariff resulting from the review of the construction variations and affirming that zone coefficients apply in contradiction with the information provided to the bidders at the time of bidding for the Concession, restraining ABA from collecting payment from its customers for services rendered before March 15, 2002, and denying to ABA access to the documentation on the basis of which ABA was sanctioned were arbitrary actions without any support in the Law or the Concession Agreement and impaired the operation of *Azurix'*s investment.[38]

Turning to compensation, the Tribunal concluded that the BIT did not provide any measure of compensation apart from cases of expropriation. The Tribunal referred to the *CMS v. Argentina* case (Section 3.2.2 above), in which the tribunal found that the standard of fair market value, which frequently figures in respect of expropriation, may be appropriate also for other breaches if their "*effect results in important long-term losses*".[39] Turning to the facts of the present case, the Tribunal found that "compensation based on the fair market value of the Concession would be appropriate, particularly since the Province has taken it over".[40] In measuring the fair market value, the Tribunal stated that the function of the Tribunal is "to try and determine what an independent and well-informed third party would have been willing to pay for the Concession in March 2002, in a context where the Province would have honoured its obligations".[41]

36 The Award, para. 375-377.
37 Article II.2(b) of the US-Argentina BIT provides: "Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments".
38 The Award, para. 390-393.
39 The Award, para. 420.
40 The Award, para. 424.
41 The Award, para. 427.

The Claimant had submitted two methodologies for determining the fair market value: the actual investment and the book value. The Tribunal agreed with the Claimant that "*the actual investment method is a valid one in this instance*".[42] The Tribunal found that the Claimant's investment in this respect was the price paid for the Concession and the additional investments made to finance ABA.

The Tribunal emphasised, however, that a significant adjustment was required to arrive at the real value of the Canon paid by the Claimant for the Concession. According to the Tribunal, no well-informed investor would at the time of the violation have paid for the Concession the price (and more particularly, the Canon) paid by *Azurix* in mid-1999, irrespective of the actions taken by the Province and of the economic situation of Argentina at that time.[43] The primary reason for this conclusion of the Tribunal appears to have been the Tribunal's findings with regard to the tariffs and tariff adjustment review provided by the Concession Agreement. The Claimant argued that under the Concession Agreement the Canon Payment should be included in the asset base that the concessionaire had the right to recover through the tariffs to be applied to the concessionaire's services under the Concession Agreement. However, in the view of the Tribunal, the Canon Payment could not be included as a recoverable asset base for the purpose of tariff increases.[44]

In light of the above factors, the Tribunal concluded that no more than a fraction of the Canon Payment could realistically have been recuperated under the existing Concession Agreement. The Tribunal therefore found that the value of the Canon at the time of the violation should be established at 60,000,000 US dollars. The Tribunal did not explain, however, how it arrived at this amount. The full Canon Payment made by the Claimant amounted to 438,555,551 US dollars.[45]

It should also be noted that the Tribunal did not award any compensation for unpaid bills owed by customers to ABA, which the Province had directed the customers not to pay, since the Tribunal found that this amount was owed by the Province to ABA and, therefore, should not be part of the compensation awarded to *Azurix*.[46] Nor did the Tribunal award compensation for certain expenditures incurred by the Claimant in connection with negotiations with the Province and the termination of the Concession, since the Tribunal found that it had not received sufficient evidence in support of such costs and that, in any case, these were costs related to the business risk that *Azurix* took when it decided to make the investment. Therefore, although agreeing in principle that compensation should wipe out the consequences of an illegal act, in the circumstances of this particular case, the Tribunal did not find the amount claimed to be justified.[47]

42 The Award, para. 425.
43 The Award, para. 426.
44 The Award, para. 427.
45 The Award, para. 429.
46 The Award, para. 431.
47 The Award, para. 432.

III. Cases Decided by Other Tribunals

1. Nykomb Synergetics Technology Holding AB v. Latvia[48]

Nykomb v. the Republic of Latvia was the first award on the merits rendered under the ECT. It was rendered on 16 December 2003 and concerned a dispute regarding the purchase of power by the state-owned Latvian company, *Latvenergo*, and the Latvian company *Windau,* a wholly owned subsidiary of the Swedish company *Nykomb*. *Latvenergo* and *Windau* entered into several agreements, according to which *Windau* would build a co-generation electric plant and *Latvenergo* would purchase the surplus electricity produced subsequently. *Windau* and *Latvenergo* had a dispute over *Windau*'s tariff. *Nykomb* argued that *Windau* was entitled to a double tariff in accordance with the Entrepreneurial Law in force at the time when the contract in question was concluded, whereas *Latvenergo* claimed that *Windau* only was entitled to a lower tariff in accordance with subsequent legislation that had amended the Entrepreneurial Law.

As to the merits of *Nykomb*'s claim, the Tribunal found that Latvia had breached its obligation under Article 10 of the ECT[49] not to discriminate against foreign investors by offering the so-called "double tariff" to certain other companies but not to *Nykomb*'s Latvian subsidiary, *Windau*, and by failing to present any evidence why those companies were different.

As to the standard of compensation applicable in case of such discrimination, the Tribunal noted that the principles of compensation provided for in Article 13(1) of the ECT, in case of expropriation, were not applicable to the assessment of damages or losses caused by violations of Article 10. The Tribunal found that "the question of remedies to compensate for losses or damages caused by the Respondent's violation of its obligations under Article 10 of the Treaty must primarily find its solution in accordance with established principles of customary international law. Such princi-

48 Stockholm International Arbitration Review, 2005:1, p. 53. See further *T. Wälde* and *K. Hobér*, The First Energy Charter Award, Journal of International Arbitration, Vol. 22, No. 2 (2005), pp. 83–103.

49 Article 10 (1) of the ECT reads as follows: "Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use enjoyment or disposal. In no such case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."

ples have authoritatively been restated in The International Law Commission's Draft Articles on State Responsibility adopted in November 2001".[50]

The Tribunal further noted that according to Articles 34[51] and 35[52] of the ILC Articles, restitution was the primary remedy. However, with respect to the case before it, the Tribunal found that restitution was a suitable remedy primarily where the state had instituted actions directly against the investor. Where the actions were directed against its subsidiary, the Tribunal instead found the appropriate remedy to be compensation for the losses or damage inflicted on the investor's investment.[53]

Nykomb claimed damages corresponding to the difference between the "double tariff" and the tariff that had actually been paid to *Windau.* However, the Tribunal decided not to give *Nykomb* the full difference between the two sets of tariffs because the higher payments would not have gone directly to *Nykomb* but to *Windau.* The Tribunal stated that "the money would have been subject to Latvian taxes etc., would have been used to cover *Windau*'s costs and down payments on *Windau*'s loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends".[54]

Taking into account the requirements under applicable customary international law of causation, foreseeability and the reasonableness of the result, the Tribunal nevertheless found that the reduced earnings of *Windau* constituted the best available basis for the assessment also of *Nykomb*'s losses. It came to the conclusion that a discretionary award of one third of the estimated loss in purchase prices of electricity up to the time of the award would serve as a reasonable basis for the quantification of *Nykomb*'s assumed losses up to the time of the award.[55]

As regards *Nykomb*'s alleged losses on delivery of electric power to *Latvenergo* for the remainder of the eight year contract period, the Tribunal found this potential loss too uncertain and speculative to form the basis of an award of monetary compensation. The Tribunal, however, considered it to be a continuing obligation of Latvia to ensure payment at the double tariff for electric power delivered under the contract for the rest of the eight year contract period. It therefore ordered Latvia to

50 Stockholm International Arbitration Review, 2005:1, p. 104-105.

51 "Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of the chapter."

52 "A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:
(a) Is not materially impossible;
(b) Does not involve a burden out of all proportion to the benefits deriving from restitution instead of compensation".

53 Stockholm International Arbitration Review, 2005:1, p. 105-108.

54 Stockholm International Arbitration Review, 2005:1, p. 105.

55 Stockholm International Arbitration Review, 2005:1, p. 107.

fulfil its obligation to pay the double tariff for future deliveries during the remainder of the contract period.[56]

2. Petrobart Limited v. Kyrgyzstan[57]

The second arbitral award on the merits rendered under the ECT was between *Petrobart Ltd* of Gibraltar and the Kyrgyz Republic. It concerned a sales contract between Petrobart and the Kyrgyz state owned company *KGM* for the purchase by the latter of 200,000 tonnes of gas condensate. The award was rendered on 29 March 2005.[58]

Petrobart delivered five shipments of gas but was only paid for the first two. At the same time as *Petrobart* turned to domestic courts for recourse, Kyrgyz authorities – as part of a reform of the system for supply of oil and gas in the Kyrgyz Republic –took certain measures that made it impossible for *Petrobart* to enforce its rights under the contract. The measures included a decision by the Kyrgyz authorities to privatize *KGM*, and to transfer its assets, but not its liabilities (including monies owed to Petrobart), to a new company as well as a request by the Vice Prime Minister of the Kyrgyz Republic who – referring to *KGM*'s critical financial standing – asked the chairman of the Kyrgyz court that previously had rendered a judgment in favour of *Petrobart*, to assist in granting a stay of the enforcement of the judgment against *KGM*. Enforcement was stayed by the court referring to the letter of the Vice Prime Minister, and before the period of stay of execution ended, *KGM* was declared bankrupt, which meant that enforcement of the judgment was no longer possible.

The Tribunal found that the Kyrgyz Government was liable for certain breaches of the ECT, specifically by virtue of its failure to provide fair and equitable treatment by transferring assets from *KGM* to the above mentioned new company to the detriment of KGM's creditors, including *Petrobart* (Article 10(1)); and by intervening in court proceedings regarding the stay of execution of a final judgment to the detriment of *Petrobart* (Article 10(12)).[59]

The Tribunal found that the Kyrgyz Republic had violated its obligations under Articles 10(1) and 10(12) of the ECT. With reference to the *Chorzów Factory* case and to ILC's Articles on State Responsibility, the Tribunal found that *Petrobart* had

56 Stockholm International Arbitration Review, 2005:1, p. 108.

57 The full text of the award is available e.g. at http://www.investmentclaims.com/decisions /Petrobart-kyrgyz-rep-Award.pdf.

58 The award was challenged at the Svea Court of Appeal in Stockholm, but the challenge was rejected.

59 Petrobart Limited *v.* the Kyrgyz Republic, p. 76. Article 10(12) of the ECT reads as follows: "Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations".

suffered damage as a result of the Kyrgyz Republic's breaches of the ECT and that *Petrobart* had to, as far as possible be placed financially in the position in which it would have found itself, had the breaches not occurred.[60]

Petrobart essentially claimed compensation for (i) the unpaid invoices for gas condensate actually delivered by Petrobart to KGM; and (ii) loss of profit with regard to the remaining deliveries under the contract.

The Tribunal found that due to the troublesome financial situation of *KGM*, *KGM* would probably not have survived irrespective of the breaches of the ECT committed by the Kyrgyz Republic.[61]

The Tribunal nevertheless found that the transfer by the Kyrgyz Republic of substantial assets belonging to *KGM* to other state entities caused substantial damage to *KGM*'s creditors, including *Petrobart*. Due to the inadequacy of the information submitted by the parties, the Tribunal found that the damage suffered by *Petrobart* could not be established with precision. The Tribunal therefore found it necessary to make a general assessment based on its appreciation of the situation as a whole. In making such assessment, the Tribunal found that the Kyrgyz Republic "as responsible for the transfer and lease of *KGM*'s assets, shall compensate *Petrobart* for damage which the Arbitral Tribunal estimates at 75% of its justified claims against *KGM*".[62]

With regard to *Petrobart*'s claim for lost profit, the Tribunal found that there remained a great deal of uncertainty as to the consequences of the breakdown of the business relations between *Petrobart* and *KGM*. The Tribunal therefore concluded that *Petrobart* had not established that it was entitled to compensation for loss of future profits.[63]

Since most of the respective Tribunals' findings regarding damages in *Nykomb* and *Petrobart* are rather fact specific, only limited conclusions can be drawn from such cases. It should be noted, however, that in the absence of express provisions on the standard of compensation, the Tribunals in both cases relied on general provisions of customary international law on state responsibility.

It could also be noted that in *Nykomb*, where the investment – the local subsidiary *Windau* – was still in operation and the contract for delivery of electric power still in force between *Windau* and *Latvenergo,* the Tribunal made a clear distinction between the damage suffered by *Nykomb* – the foreign investor – and the damage suffered by *Windau.* The Tribunal only awarded damages that would compensate *Nykomb* for the damage, that it had actually suffered, and not for losses suffered by *Windau*. *Nykomb*'s damage was quantified as a proportion of the earnings that would have been generated by Windau, had there not been any breach of the treaty, *i.e*. the Tribunal estimated the dividends that would have been received by *Nykomb*

60 Petrobart Limited v. the Kyrgyz Republic, p. 77-78.
61 Petrobart Limited v. the Kyrgyz Republic, p. 81.
62 Petrobart Limited v. the Kyrgyz Republic, p. 83-84.
63 Petrobart Limited *v.* the Kyrgyz Republic, p. 86-87.

from its subsidiary, rather than establishing a reduction of the value (if any) of Nykomb's shares in Windau.

3. S.D. Myers, Inc. v. Canada

In *S.D. Myers, Inc. v Canada*[64], S.D. Myers, Inc (*SDMI*) (USA) claimed that Canada had failed to comply, *inter alia*, with its obligation under Article 1105 of the NAFTA[65] to treat investors of another party to the NAFTA in accordance with international law, including fair and equitable treatment. *SDMI,* an Ohio corporation that processed and disposed of PCB waste, alleged that Canada's ban on the export of *PCB* wastes from Canada to the United States in late 1995 had resulted in *SDMI* suffering economic harm to its investment through interference with its operations, lost contracts and opportunities in Canada.

In its first Partial Award of 13 November 2000 the Tribunal held that Canada had breached the fair and equitable treatment obligation of Article 1105 of the NAFTA. As regards the principles for compensation the Tribunal stated that in non-expropriation cases the drafters of the NAFTA had left "it open to Tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of the NAFTA".[66] The Tribunal further concluded that in some non-expropriation cases a Tribunal might find it appropriate to adopt the fair market approach and in some not. In this case the Tribunal found that the fair market value standard was not a logical, appropriate or practicable measure of the compensation to be awarded. Instead the Tribunal cited the *Chorzów Factory* case and stated that "whatever precise approach is taken, it should reflect the general principle of international law that compensation should undo the material harm inflicted by a breach of an international obligation".[67] Further, the Tribunal made clear that it was for *SDMI* to prove the quantum of the losses. The Tribunal also stated that compensation is payable only in respect of harm that is proved to have a sufficient casual link with the specific NAFTA provision that has been breached, and that double recovery must be avoided in situations *e.g.* when several NAFTA provisions have been breached.[68]

In the second Partial Award of 21 October 2002 the Tribunal held that "the appropriate loss to be considered in this particular case is the loss of net income stream".[69] The Tribunal noted that this approach formed part of the submissions of

64 8 ICSID Reports (2005) 18.

65 Article 1105(1) of NAFTA reads as follows: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security".

66 First Partial Award para. 309.

67 First Partial Award para. 315.

68 First Partial Award para. 317.

69 Second Partial Award, para. 100.

both parties and, further, that expert accountants retained by both sides agreed that *SDMI*'s lost income stream was capable of rational assessment.

In order to asses the compensation due to *SDMI* as a result of Canada's export ban on *PCB* the Tribunal used a 12-step methodology aimed at determining the net income stream lost by SDMI plus compensation for abridged opportunity and delay.[70] The Tribunal finally determined the total compensation (excluding interest) by using this methodology to CAN$6,050,000.

4. Marvin Feldman v. Mexico

Marvin Feldman v. Mexico[71], concerned a dispute regarding the application of certain Mexican tax laws to the export of tobacco products by *CEMSA*, a company organized under the laws of Mexico and owned and controlled by the Claimant, Mr. *Feldman*. The Claimant alleged that Mexico's continuing refusal to recognize *CEMSA*'s right to a refund of certain Mexican taxes in connection with cigarette exports constituted a breach of Mexico's obligations under Chapter Eleven of NAFTA.

In most instances, when cigarettes were purchased in Mexico at a price that included tax, and subsequently exported, the tax amounts initially paid could be refunded. However, in 1991 the law was changed so that only producers – not resellers such as Claimant – became eligible for the refund. Subsequently, resellers again became eligible for the refund, but the Claimant did not manage to meet statutory invoice requirements, as the invoices from the volume retailers, from which the Clamiant purchased, did not itemize the tax on the invoice. This eventually forced Claimant to shut down its business.

Claimant argued, *inter alia,* that Mexico discriminated against *CEMSA*, since Mexican authorities permitted at least three Mexican owned resellers of cigarettes to export cigarettes and to receive refunds, notwithstanding the fact that like the Claimant, they purchased their goods from retailers, and, thus, could not have invoices stating the tax amounts separately.

The majority of the Tribunal found that the evidence available supported that the Claimant was denied the refunds at a time when at least three Mexican companies in like circumstances, i.e. resellers and exporters, were granted them. The majority therefore found that Mexico had violated the Claimant's right to non-discrimination under Article 1102 of NAFTA.[72]

Concerning the quantum of damages to be awarded to the Claimant, the Tribunal observed that NAFTA provides no guidance as to the proper measure of damages or compensation for situations that do not fall under Article 1110 (expropriation). The

70 Second Partial Award, para. 229.
71 ICSID Case No. ARB(AF)/99/1, Award 16 December 2002.
72 The Award, para. 173 *et seq*.

Tribunal found that "in case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110".[73] The Tribunal, thus, dismissed the Claimant's claim for compensation equivalent to *CEMSA*'s "going concern value", because compensation for the full market value of *CEMSA* would require a finding of expropriation.[74] Since, most parts of the Claimant's claim for loss of profits were time barred under NAFTA Article 1117(2), the only thing that remained of Claimant's claim was three months tax refunds relating to the period after the cut-off date. Compensation for such claim was awarded by the Tribunal with 9,464,627.50 Mexican pesos (about 946,462 U.S. dollars) after certain adjustments for miscalculations and reductions for amounts relating to cigarettes exported to tax havens, since the latter amounts would not have been eligible for refunds under Mexican law.[75]

5. Pope & Talbot Inc. v. Canada

In *Pope & Talbot Inc. v. Canada*[76], Pope & Talbot claimed that Canada's implementation of the 1996 Softwood Lumber Agreement (SLA) between Canada and the US, which among other things regulated the export of softwood lumber from Canada to the US, *inter alia,* violated Article 1105 of the NAFTA, according to which parties have an obligation to treat investors of another party to the NAFTA in accordance with international law, including fair and equitable treatment. Under the SLA export fees were levied on exports of softwood lumber out of Canada to the U.S., unless the exports came within a certain annual quota for all such softwood lumber exports. There was also a certain export quota on which a lower fee was levied. *Pope & Talbot* alleged that a number of measures taken by Canada with regard to the allocation of the above export quotas violated Article 1105.

The tribunal found that whereas Canada's quota allocations were handled in a reasonable manner, the handling of a certain "verification review procedure" regarding information underlying *Pope & Talbot*'s quota applications initiated by Canada's Softwood Lumber Division (SLD), constituted a denial of the investor's fair treatment required by NAFTA Article 1005. In the view of the Tribunal, the actions undertaken by SLD meant that *Pope & Talbot* was subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense

73 The Award, para. 194.
74 The Award, para. 198.
75 The Award, para. 202 *et seq*.
76 UNCITRAL Award, 10 April 2001, www.investmentclaims.com.

and disruption in meeting SLD:s requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles.[77]

In its award on damages[78], the Tribunal did not expressly discuss the standard of compensation to be applied in case of violations of fair and equitable treatment under NAFTA Article 1105. In light of the Tribunal's conclusions with regard to liability, the Tribunal simply awarded the investor compensation for costs and expenses incurred due to SLD:s "verification review procedure", which primarily included accountants' and legal fees as well as expenses incurred in lobbying efforts.[79] The Claimant's claim for compensation for the value of management time devoted to the "verification review procedure" was denied, since the Tribunal found management costs to be a fixed cost that the Claimant would have had irrespective of the "verification review procedure".[80]

D. Concluding Remarks

As mentioned above there are few arbitral awards dealing with the issue of compensation for violations of the fair and equitable treatment standard. This means that caution is required when trying to draw general conclusions from such awards. It is submitted that it is in fact too early to draw any general conclusions at all. The cases discussed in this contribution show that there is, for the time being, no general approach to this issue. Only time will tell if there will ever be such a general approach. This notwithstanding, some preliminary observations come to mind.

First, given the absence of treaty provisions in this area, tribunals rely – as they must – on customary international law. Guidance is usually sought from the ILC Articles on State Responsibility which in turn build on the principles laid down in the *Chorzow Factory* case. This is, however, only the first step in that it establishes the *standard* of compensation. As stated in Article 31 of the ILC Articles the standard is "full reparation"

Second, when it comes to the *method* of establishing and calculating "full reparation", customary international law does not provide much guidance. The cases discussed above illustrate that the method chosen depends on, and varies with, the circumstances of each individual case, including, *inter alia*, the nature of the violation of the fair and equitable treatment standard and the kind and nature of the investment in question. Sometimes the starting point might be the amount actually invested, in other cases it might be more appropriate to focus on lost future profits as established by using the DCF method.

77 The Award, para. 181.
78 UNCITRAL Award, 31 May 2002, www.investmentclaims.com.
79 The Award, para. 85.
80 The Award, para. 82.

Third, it would seem that the issue of causality has the potential of creating more problems in this context than in relation to compensation for expropriation. One possible explanation is that violation of the fair and equitable treatment standard does not automatically result in the elimination of the investment, as is mostly the case with expropriation, but rather results in a decline in the business in question, or in other negative impact on it. The difficulty is to determine the extent to which this is caused by the violation of the fair and equitable treatment standard.

The "Foreign Nationality"-Requirement and the "Exhaustion of Local Remedies" in Recent ICSID Jurisprudence

Richard Happ[*]

I have been asked to analyse recent jurisprudence[1] of arbitral tribunals constituted under the auspices of the "International Centre for the Settlement of Investment Disputes" (hereinafter "ICSID tribunals" or "tribunals") relating to the "foreign nationa-lity – requirement" and the rule of exhaustion of local remedies. The scope of this report is restricted to awards and decisions rendered between 2001 and 2006.

A. Introductory Remarks

I. ICSID Convention and Diplomatic Protection

The "foreign nationality"-requirement can be located in Article 25 (1) ICSID Convention[2] which sets out the general requirements for the jurisdiction of an ICSID tribunal. The exhaustion of local remedies is not something which the ICSID Convention requires. To the contrary, Article 26 ICSID Convention sets out that a Contracting State "may require the exhaustion of local remedies as a condition of its consent to arbitration under this Convention."

Both issues are not privy to the ICSID Convention, but have developed as part of the right of states to grant diplomatic protection to their nationals. States are only entitled to bring a claim on behalf of their nationals once that national has exhausted the local remedies. In the *ELSI*-case, the International Court of Justice qualified this rule as "an important principle of customary international law."[3]

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1 If not explicitly stated, the awards and decisions cited in this paper can be found on the website of ICSID at www.worldbank.org/icsid/ or at the following private websites: www.Investmentclaims.com or http://ita.law.uvic.ca/chronological_list.htm.

2 Convention on the Settlement of Investment Disputes between States and Nationals of other States, Washington, 18. März 1965, I.L.M. 4 (1965), 524; in force since 14.10.1966 (hereinafter the „ICSID-Convention").

3 1989 I.C.J. Reports 42, para. 50.

In the area of investment disputes, diplomatic protection has been factually replaced by treaty-based investment arbitration as a means of dispute settlement[4]. The current caseload of ICSID consists nearly exclusively of disputes relating to the alleged breach of a bi- or multilateral investment treaty (hereinafter "BITs").

Notwithstanding this, one must be aware that within the framework of the ICSID Convention, the foreign nationality requirement and the exhaustion of local remedies have a different function than they have within the framework of diplomatic protection. The jurisdiction of ICSID extends to all kinds of investment disputes, whether they are based on contract, national law or treaty, as long as the requirements of Article 25 (1) ICSID Convention are fulfilled. In contrast, diplomatic protection is restricted to alleged breaches of international law. Regard must be had to this different function when interpreting the ICSID Convention.

II. ICSID Convention and Investment Protection Treaties

The basis for the jurisdiction of an arbitration Tribunal is a respective agreement of the parties. Article 25 (1) ICSID Convention incorporates this by requiring the 'consent' of the parties to submit their dispute to Centre.

Where a dispute is based on a bilateral investment treaty ("BIT"), the consent of the state is contained in the dispute settlement clause of the BIT. In terms of an agreement, the dispute settlement clause constitutes the offer of the state made to nationals of the other state. The investor consents to arbitration – and accepts the offer of the state - by filing its request of arbitration. Thus, provisions in the dispute settlement clause dealing with nationality and exhaustion of local remedies become part of the arbitration agreement.[5]

An arbitration agreement must conform to the requirement of Article 25 ICSID Convention in order for an ICSID tribunal to have jurisdiction. It follows that from the perspective of the ICSID Convention, the provisions in a BIT dealing with nationality and exhaustion of local remedies are conceptually subordinated to the ICSID Convention.

4 For an analysis of that change (and some of its implications) cf. *Happ*, Schiedsverfahren zwischen Staaten und Investoren nach Artikel 26 Energiechartavertrag. Eine Studie zum Wandel der Streitbeilegung im Investitionsschutzrecht unter den Bedingungen einer globalen Weltwirtschaft (2000).

5 *Schreuer*, The ICSID-Convention: A Commentary, Article 25 mn. 481.1.

B. The "Foreign Nationality"-Requirement

I. The General Rule

Article 25 (1) ICSID Convention sets out that the
"jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre".

To fall under the jurisdiction of the Centre, a dispute must thus arise between a Contracting State and a national of another Contracting State. The nationality requirement is considered not to have the same importance as in the field of diplomatic protection. In the framework of the Convention, the 'foreign nationality'-requirement is only the means to bring an investor within the jurisdiction of the Centre[6].

In Article 25 (2) (a-b), the Convention clarifies that a "national of another Contracting State" can be an individual or a juridical person. The Convention does not define the concept of nationality. Whether an individual or a juridical person is a national of a Contracting State is, in the first instance, a matter of the law of that Contracting State[7]. The possession of the nationality of a certain state can be proven by passports and/or certificates of nationality, although tribunals are not bound by these documents. In *Hussein Nuaman Soufraki v. United Arab Emirates*[8], the Claimant had submitted certificates of nationality issued by the Italian authorities to the tribunal. While it agreed with Prof. *Schreuer* that certificates of nationality should be given appropriate weight, it noted that such documents did not preclude a contrary decision by the tribunal[9]. Analyzing the submitted documents in detail, the tribunal found no evidence that the Italian officials who issued the certificates were aware that the Claimant had lost his Italian nationality. In cross-examination, the Claimant also admitted that he had not informed any Italian official of his loss of nationality, since he himself did not believe that he had lost it. Consequently, the tribunal held that the Claimant could not rely on any of these certificates or on the letter of the Italian foreign ministry[10]. The tribunal was therefore compelled to determine for itself whether the Claimant reacquired Italian nationality after 1991. Italian law provided for that possibility, requiring only the taking up of residence in Italy for a

6 *Sinclair*, The Substance of Nationality Requirements in Investment Treaty Arbitration (yet unpublished paper), p. 3-4 (citing *Broches* and *Amerasinghe*).
7 *Schreuer*, The ICSID-Convention: A Commentary, Article 25 mn. 429, 460.
8 *Hussein Nuaman Soufraki v. United Arab Emirates*, Case No. ARB/02/7, Award of 7 July 2004 (*Fortier* (presiding), *Schwebel*, *El Kholy*). The case arose on the basis of the BIT between Italy and the United Arab Emirates.
9 *Id.*, para. 63.
10 *Id.*, para. 66-68.

period of not less than a year. Reviewing the evidence submitted, it found that the Claimant could not prove that he had fulfilled this requirement, and thus concluded that he was not an Italian national[11]. As a result, the tribunal decided that the dispute was outside its jurisdiction. The Claimant could not rely on the BIT between Italy and the United Arab Emirates.[12]

II. Nationality of Individuals

Article 25 (2) (a) ICSID Convention clarifies that the investor must not have the nationality of the Contracting State which is a party to the dispute. The ICSID Convention does not prohibit double nationality as long as the investor has the nationality of at least one Contracting State[13]. It is only where the investor has both the nationality of the host state and of another Contracting State that he will not be able to resort to ICSID jurisdiction. This proved fatal for some of the claimants in *Champion Trading et. al v. Arab Republic of Egypt*[14]. The individual claimants had both U.S. and Egypt nationality and relied on their Egyptian nationality when making the investment in Egypt. The tribunal thus held that their claims were outside its jurisdiction.

The principle of effective nationality, which the International Court of Justice had pronounced in the *Nottebohm*[15] case, seems also have to been accepted with regard to investment disputes[16]. Within the period under review, however, no ICSID tribunal seems to have issued a holding dealing with this principle. It was an issue raised by the individual claimants in *Champion Trading*, but considered not decisive since those claimants had US nationality.

Article 25 (2) (a) imposes two temporal limitations: the investor must have the nationality of another Contracting State at the time when both parties consented to ICSID jurisdiction and at the time when the request for arbitration[17] was registered. The continuous nationality - rule proclaimed by the tribunal in *Loewen v. United*

11 *Id.*, para. 81.

12 The claimant could not accept the offer made by the United Arab Emirates to nationals of Italy to submit disputes to ICSID arbitration, since he was no Italian national. The possible precedential value of the decision is thus not restricted to ICSID cases.

13 *Schreuer*, Article 25 mn. 438.

14 *Champion Trading et al. v. Arab Republic of Egypt*, Case No. ARB/02/09, Decision on Jurisdiction of 21 October 2003 (*Briner* (presiding), *Yves Fortier*, *Aynès*).

15 ICJ, *Nottebohm Case* (Lichtenstein v. Guatemala), Second Phase, Judgement of 6 April 1955, ICJ Reports 1955, p. 4 *et seq.*

16 *Schreuer*, mn. 439; *cf. Feldman Karpa v. Mexico*, Case No. ARB(AF)/99/1, Interim decision on preliminary jurisdictional issues of 6 December 2000 (*Bravo*, *Gantz*, *Kerameus*), para. 32. Cf. also *Wisner/Gallus*, JWIT 2004, 927, 930-933.

17 ICSID Arbitration is initiated by a request for arbitration, Article 36 (1) ICSID Convention.

States[18] might apply to treaty-based investment disputes. But since the ICSID system is also open for mere contractual disputes, the ICSID Convention does not require continuous nationality. The investor may change its nationality as long as he/she fulfils the requirements of Article 25 (2) (a) ICSID Convention[19]. Of course, this is without prejudice to a possible rule of continuous nationality under applicable bi- or multilateral investment treaties or customary international law[20] in a treaty-based investment dispute.

III. Nationality of Juridical Persons

1. General Rule

Article 25 (2) (b) ICSID Convention provides that a "national" is also
"any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention."

The Convention does not define the concept of "juridical person". It seems, however, to be generally accepted that legal personality is a necessary prerequisite for being a "juridical person", and that mere associations of individuals are not sufficient[21]. In *Impregilo v. Pakistan*, the Tribunal thus held that the Claimant could not bring a claim on behalf of an unincorporated Swiss joint venture, which it considered to be not a juridical person[22]. It is to be noted that several BIT's, *inter alia* the new German-Chinese BIT, provide that "investors" can also be entities without legal

18 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America*. Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*). For a critical review, see *Rubins*, Loewen v. United States: The Burial of an Investor-Statee Arbitration Claim, Arbitration International 21 (2005), 1 *set seq*.

19 *Schreuer*, Article 25 mn. 452, 453.

20 Cf. *Dugard*, Addendum to the first report on diplomatic protection, UN Doc. A/Cn.4/506/Add.1. *Dugard* concludes (on p.10): "12. The dubious status of the requirement of continuity of nationality as a customary rule is emphasized by the uncertainties surrounding the content of the alleged rule. There is no clarity on the meaning of the date of injury, nationality, continuity and the *dies ad quem* (the date until which continuity of the claim is required)."

21 *Schreuer*, Art. 25 mn. 457-459.

22 *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction of 22 April 2005 (*Guillaume* (presiding), *Cremades, Landau*), para. 132. Cf. also *Consorzio Groupement L.E.S.I. – Dipenta v. Algeria*, Award on 10 January 2005 (*Tercier* (presiding), *Faurès*, *Gaillard*), par. 34/37.

personality[23]. Those investors thus will not qualify as"juridical persons" pursuant to Article 25 (2) (b) ICSID Convention[24].

The nationality of juridical persons is primarily determined by the national law of the state whose nationality is claimed. Usually, corporate nationality is determined by the place of incorporation and/or the head office of the juridical person. These criteria have been adopted consistently by ICSID Tribunals[25]. Control of the corporation by nationals of that state is not considered a necessary criterion[26], since Article 25 (2) (b) presupposes that a juridical person has the nationality of the host state, but is controlled by nationals of another Contracting state. Provisions on nationality in national investment laws and investment treaties which provide for ICSID jurisdiction form part of the legal framework of the Contracting State party to the dispute and/or of the arbitration agreement.

2. Agreement to Treat a Juridical Person as a Foreign National

Pursuant to Article 25 (2) (b), the parties to the dispute may agree to treat a juridical person which has the nationality of the host state, but is controlled by nationals of another Contracting State, as a national of another Contracting State. Such an agreement should normally be explicit to avoid any doubts[27]. However, ICSID tribunals have been generous in assuming an implicit agreement at least in cases where the state had agreed to ICSID jurisdiction with a locally incorporated company[28]. BIT's may also contain a respective explicit offer of the State, which upon acceptance by the investor becomes part of the arbitration agreement. Absent such an explicit offer, no tacit agreement can be deduced from the conclusion of a BIT.

While parties may agree explicitly or implicitly on treating a juridical person as a foreign national, it is an objective requirement that the juridical person must be con-

23 Cf. Art. 1(2) (a) of German-Chinese BIT, pursuant to which an investor (as regards the Federal Republic of Germany) is: "any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany". An English-language version of the BIT can be found at http://www.iisd.org/pdf/2006/itn_germany_china_bit_2003.pdf.

24 It is to be noted that the German-Chinese BIT provides only for ICSID jurisdiction, unless the parties agree otherwise. Since it seems extremely unlikely that China would agree to the jurisdiction of a different forum to enable an investor to bring a claim, the consequence seems to be that only the individuals behind those entities can file a claim.

25 *Schreuer*, Art. 25 mn. 460. In the period under review, no tribunal seems to have deviated from this general rule.

26 *Schreuer*, Art. 25 mn. 463.

27 ICSID has published several model arbitration clauses. The respective clause no. 7 (to be found at: http://www.worldbank.org/icsid/model-clauses-en/9.htm#c) reads as follows: "It is hereby agreed that, although the Investor is a national of the Host State, it is controlled by nationals of name(s) of other Contracting State(s) and shall be treated as a national of [that]/[those] State[s] for the purposes of the Convention."

28 *Schreuer*, Art. 25 mn. 519.

trolled by nationals of another Contracting State. Control is primarily exercised via majority shareholding[29]. Often, the foreign national is a juridical person and only the first link in a chain of juridical persons of different nationality. In such cases, the questions arises whether a Tribunal has to stop at the first level of control, or can 'look through the corporate veil' of the controlling foreign national to determine whether there are further controlling companies of different nationality, and determine which one of them exercises 'effective' control. Past tribunals seem to have decided differently: in *Amco*[30], the tribunal stayed with the first-tier foreign shareholder, while in *SOABI*[31] the tribunal searched for real control and went one step further to second-tier control.[32]

In *Autopista Concesionada de Venezuela v. Venezuela* ("*Aucoven*"), *Aucoven* was controlled by the US corporation Icatech, which in turn was 100%-owned by the Mexican company ICA Holding. As Venezuela submitted, ICA Holding exercised direct control over its subsidiaries, including *Aucoven*. Venezuela thus argued that the 'effective' control thus lay with a Mexican company (not a Contracting State). The tribunal did not accept that Art. 25 (2) (b) required 'effective control', observing that the ICSID convention does not know such a requirement, and that it would be difficult and impractical to apply.[33] The tribunal then considered that the parties in their agreement had placed emphasis on the majority shareholding in *Aucoven*, and considered the majority shareholding to be a reasonable test for control[34] and within the limits imposed by the ICSID Convention.

The issue of "direct" or "effective control", albeit with regard to a respective BIT-clause, was also one of the main contentious issues in *Aguas del Tunari S.A.*

29 See *infra* the discussion of the cases *Autopista v. Venezuela and Aguas de Tunari v. Boliva*. This is irrespective of the fact that very often less than majority shareholding can be sufficient to control a corporation. Cf., *inter alia*, *International Thunderbird Gaming Corporation v. Mexico*, Award of 26 January 2006 (*van den Berg* (presiding), *Ariosa*, *Waelde*), para. 105-110.

30 *Amco v. Indonesia*, Decision on Jurisdiction of 25 September 1983, 1 ICSID Reports 396. The Tribunal held, however, that in exceptional circumstances it might search for the true controller of a company (*id.*, para. 14): "… in fact, it could be so where for political or economical reasons, it matters for the Contracting State to know the nationality of the controller or the controllers, and where it is proven that would the Contracting State have known this nationality, it would not have agreed to the arbitration clause; such a situation might possibly be met in exceptional instances".

31 *SOABI v. Senegal*, Decision on Jurisdiction of 1. August 1984, 2 ICSID Reports 182/3.

32 Cf. *Wisner/Gallus*, JWIT 2004, 927, 936 analyze these two decisions and argue that :"These facts suggest that investor-State tribunals will look through holding companies to determine control but will not look through companies pursuing activities in the jurisdiction in which they are incorporated."

33 *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, Case No. ARB/00/5, Decision on Jurisdiction of 27 September 2001 (*Böckstiegel, Cremades, Kaufmann-Kohler* (presiding)), para. 112-113.

34 *Id.*, para 117-121. Article 64 of the contract between the parties provided that if the majority of the shares should be sold to a national of a Contracting State of the ICSID Convention, then disputes should be settled at ICSID.

v.Republic of Boliva[35]. Aguas del Tunari S.A. ("*AdT*") is a Bolivian company the shares of which were owned – after some changes – by a chain of Dutch holding companies, the last one of which was held in equal parts by another subsidiary of the US company Bechtel Enterprise Holding, Inc ("Bechtel")and by the Italian company Edison S.p.A ("Edison") directly.

When a dispute arose, *AdT* brought a claim on the basis of the Netherlands-Bolivian BIT, Article 1 (b) (iii) of which provides that "nationals" of a Contracting Party (to the BIT) are also "legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the laws of the other Contracting Party". *AdT* thus claimed that it should be considered as a Dutch national, since it was controlled by Dutch companies. Bolivia objected to the jurisdiction of the Tribunal, arguing that *AdT* was not controlled by Dutch companies, but by Bechtel.

The Tribunal thus had to determine whether the indirect ownership of *AdT's* shares was sufficient, or whether the Dutch companies did not exercise control, as they in turn were owned by Bechtel and Edison. It noted that majority ownership of shares was generally considered to be sufficient for control and that it was nearly impossible to draw the line between formal control and 'actual control' required by Bolivia[36]. After a lengthy analysis of the holding structure and the provisions of the BIT, the Tribunal considered that majority ownership of shares was sufficient for 'control'[37] and that *AdT* was controlled by Dutch nationals.

3. Foreign Juridical Persons Controlled by Nationals of the Host State

No clear and uniform opinion, however, exists with regard to cases where the foreign juridical person, be it direct investor or only shareholder of the investor, is not owned and controlled by third-state nationals, but by nationals of the host state. To imagine such a situation might cause a certain kind of uneasiness, since the 'foreign' investor in fact would not be foreign at all. In his 2000 commentary on the ICSID Convention, Prof. *Schreuer* described this uneasiness as follows: "[I]f the immediate controller is a national of a Contracting State which is, in turn, controlled by nationals of non-Contracting States or even by nationals of the host state? Realism would militate against jurisdiction in such a case."[38]

The landmark decision in this respect seems to be the decision on jurisdiction in *Tokios Tokeles v. Ukraine*[39]. The dispute arose on the basis of the bilateral invest-

35 *Aguas del Tunari, S.A. v. Republic of Bolivia*, Case No. ARB /02/3, Decision on Respondent's Objections to Jurisdiction of 21 October 2005 (*Caron* (presiding)*, Alberro-Semerena, Alvarez*).

36 *Aguas de Tunari*, para. 246.

37 *Aguas de Tunari*, para. 264.

38 *Schreuer*, Art. 25 mn. 562.

39 *Tokios Tokeles v. Ukraine*, Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004 (*Weill* (presiding), *Bernardini*, *Price*).

ment treaty between Lithuania and Ukraine (the "BIT"). The Claimant, *Tokios Tokeles*, is a business enterprise established under the laws of Lithuania. It is owned and controlled by Ukrainian nationals, which hold ninety-nine percent of the company's outstanding shares. In 1994, *Tokios Tokeles* created *Taki spravy*, a wholly owned subsidiary established under the laws of Ukraine. *Tokios Tokeles* alleged that, beginning in February 2002, governmental authorities in Ukraine engaged in a series of actions with respect to *Taky spravy* that breached Ukraine's obligations under the BIT.

Ukraine argued that *Tokios Tokeles* should not be considered a 'genuine national' of Lithuania, since it was predominantly owned and controlled by Ukrainian nationals and also had no substantial business activities in Lithuania. To find jurisdiction, Ukraine argued, would be tantamount to allowing claims of nationals against their own governments and incompatible with the object and purpose of the ICSID convention.[40]

The Tribunal considered that under the BIT, the claimant's incorporation in Lithuania was sufficient to qualify it as an 'investor' of Lithuania. The Tribunal refused to apply a further 'control' or 'substantial business activity' test. It considered the lack of 'denial of benefits' provision to be a deliberate choice of Ukraine and Lithuania. Accordingly, *Tokios Tokeles* was held to be an 'investor' under the terms of the BIT.[41] The Tribunal then turned to Article 25 of the ICSID Convention.[42] Ukraine had asked the Tribunal to apply Article 25(2)(b) to create an exception to the state-of-incorporation rule of nationality. The Tribunal found no support in the text of the Convention for such an approach. It considered the object and purpose of Article 25(2)(b) to be expansion of jurisdiction, rather than limiting it.[43] The Tribunal also refused to apply the doctrine of "piercing the corporate veil". While it acknowledged that the doctrine formed part of customary international law, and that *Barcelona Traction*[44] was the seminal case affirming that proposition, it noted that Ukraine had not demonstrated that the requirements for veil-piercing had been met.[45] The Tribunal then found that its conclusions were consistent with earlier ICSID awards and the views of ICSID scholars.[46]

The chairman, Prof. Prosper *Weill*, dissented. He noted that "the approach taken by the Tribunal on the issue of principle raised in this case for the first time in ICSID's history is in my view at odds with the object and purpose of the ICSID Convention and might jeopardize the future of the institution."[47] Professor *Weill* criticized the majority's assumption that the origin of invested capital was not deci-

40 *Id.*, para. 22.
41 *Id.*, para. 38.
42 *Id.*, paras. 42-52.
43 *Id*., para. 46-49.
44 Case concerning the *Barcelona Traction, Light & Power Company, Ltd*. (note 9).
45 *Tokios Tokeles Award* (note 61), para. 53-56.
46 *Id.*, para 58-70.
47 Dissenting Opinion of *Professor Prosper Weil*, para. 1.

sive, denouncing this approach as "flying in the face of the object and purpose of the ICSID Convention and system". Relying *inter alia* on the preamble of the Convention and the Report of the Executive Directors on the Convention, he noted that the

"ICSID mechanism and remedy are not meant for investments made in a State by its own citizens with domestic capital through the channel of a foreign entity, whether pre-existent or created for that purpose."[48]

Quite the contrary decision seems to have been reached in the *Loewen*[49] case (an ICSID Additional Facility dispute). It is noteworthy that the Tribunal decided to pierce the corporate veil (although apparently denying that). After the Claimant had filed for bankruptcy in the US, all of its business operations were reorganized under the mantle of a United States corporation. The Canadian Loewen Group, immediately prior to its going out of business, assigned all of its right, title and interest to the NAFTA claim to a newly created corporation called Nafcanco. The tribunal considered that not Nafcanco, but the new US corporation should be considered as 'real' claimant

"By the terms of the assignment, the only item being assigned was this NAFTA claim. All of the assets and business of TLGI have been reorganized under the mantle of an American corporation. All of the benefits of any award would clearly inure to the American corporation. Such a naked entity as Nafcanco, even with its catchy name, cannot qualify as a continuing national for the purposes of this proceeding."[50]

4. Mail Box-Companies and Shells

Since 'control' is no requirement under the ICSID convention for the nationality of juridical persons (with the exception of Article 25 (2) (b)), it is in principle both possible and permissible[51] for an investor from a non-Contracting State to channel investments into a host country via the subsidiary in a third state which is a Contracting State. This may lead to disputes where the 'formal investor' is a mere mailbox company or 'shell' created for the purpose of achieving ICSID-jurisdiction[52].

48 *Id.*, para. 19.

49 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America.* Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*).

50 Id., para. 237.

51 *Aguas de Tunari*, para 330: "[…] it is not uncommon in practice, and - absent a particular limitation - not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT."

52 Although that seems unlikely. The primary driving factor for the structuring of a foreign investment is the existence of double taxation agreements. To prevent 'treaty shopping' in the field of double taxation agreements, many states, including Germany (§ 50d III EStG), have enacted 'denial of benefits'-provisions in their internal law which deny the advantages of a DTA to such mailbox companies. The scope of these provisions is similar to a denial of benefits-provision under a BIT.

The ICSID Convention does not contain explicit substantive requirements to prevent such a 'treaty shopping'-approach, but leaves it to the agreement of the parties to determine who is deemed to be a 'foreign national'. If the consent of the state is contained in a national law or a BIT, it is up to the contracting parties to include a respective "denial of benefits" provision. Several BIT's contain "denial of benefits"-provisions, pursuant to which the provisions of the Treaty are not applicable to companies controlled by third-state nationals (e.g. of states not party to that treaty), if those companies have no substantial business activity of their own. Respective arguments have been advanced, *inter alia*, by the state parties in *Generation Ukraine v. Ukraine* and in *Nova Plama A.D. v. Bulgaria*, but to no avail. In both cases, the tribunals considered that the requirements of the denial of benetifs-provision were not fulfilled.

Absent such a denial of benefits-provision, it seems that control by third-state nationals would not affect ICSID jurisdiction as long as the third state is a Contracting State to the ICSID convention.

It needs to be noted, however, that in several disputes the Contracting State parties have raised the objection that the Claimant was a mere shell which was created for the sole purpose of gaining access to ICSID jurisdiction. In each of these cases, the tribunals did not dismiss that objection *per se*, but were careful to show that the objection was unfounded on the facts.

In *Autopista v. Venezuela*, Venezuela had asserted that Icatech would be a corporation of convenience. The Tribunal analysed the context in which Icatech acquired shares in the claimant and considered that the assertion to be unfounded[53]. In *Tokios Tokeles v. Ukraine*, the tribunal did not in principle refuse to apply the doctrine of piercing the corporate veil, but merely considered that the requirements for doing so had not been fulfilled. In *Aguas de Tunari v. Bolivia*, Bolivia had asserted that the two Dutch companies were mere shells set up to obtain ICSID jurisdiction. The tribunal did not refuse that argument as being irrelevant *per se*, but concluded that both companies were not shells[54]. In its concluding observations, the tribunal also noted that it "does not find a sufficient basis in the present record to support an allegation of abuse of corporate form or fraud"[55]. It did not reject the respective allegation of Bolivia as irrelevant.

The reasoning of these cases does not indicate whether they considered the "shell-issue" to be part of the ICSID Convention or rather part of the respective bilateral investment treaty. Two recent non-ICSID awards, however, indicate that the shell-issue might be considered a part of the respective offer of the state party in a BIT to submit the dispute to arbitration.

53 *Autopista v. Venezuela*, paras. 123-126.
54 *Aguas de Tunari*, para. 320-323.
55 *Id.*, note 331.

In *X v. Kazakhstan*[56], an SCC case on the basis, *inter alia*, of the US-Kazakhstan bilateral investment treaty, the Tribunal was faced with Respondent's objection that the US corporate claimant was a mere shell controlled by non-U.S. nationals, possibly even Kazakh citizens. The Claimant had failed to produce documentation concerning its shareholders. The Tribunal noted that several provisions of the BIT related to ownership and control. It concluded that the Claimant was thus obliged to provide

"the necessary information and evidence concerning the circumstances of ownership and control, directly or indirectly, over [Claimant-investor] at all relevant times".[57]

Since the Claimant had not provided any evidence that U.S. citizens or companies had any degree of control over the Claimant, the Tribunal concluded that it had not been established that it had jurisdiction on the basis of the Treaty.

In Saluka Investments *BV v. Czech Republic*[58], the Tribunal came to a different conclusion. It was faced with the objection that the Claimant was a mere shell controlled by its UK parent company. The Tribunal observed that it had

" some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty."

However, it refused to find an implied "control"-requirement in the provisions of the Czech-Netherlands BIT.

"The Tribunal cannot in effect impose upon the parties a definition of "investor" other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add".[59]

While several tribunals seem to have accepted the argument that mail-box companies and shells set up for the mere purpose of obtaining access to arbitration should be denied that access, the jurisprudence is not yet uniform. However, none of the Tribunals seem to have interpreted an implied "control"-requirement into the ICSID-Convention. Also, both ICSID- and non-ICSID tribunals have pronounced on the shell-issue. That suggests that if an implied control-requirement exists, it must be found in the state's offer to arbitrate contained in the respective BIT.

56 Jurisdictional Award rendered in 2003 in SCC Case 122/2001, Stockholm International Arbitration Review 2005:1, 123.

57 *Id.*, 151-152.

58 *Saluka Investment BV v. Czech Republic*, Partial Award of 17 March 2006 (*Sir Arthur Watts* (presiding), *Fortier, Behrens*).

59 *Id.*, paras. 240-241.

C. Exhaustion of Local Remedies

I. Exhaustion of Local Remedies in International Law

The exhaustion of local remedies rule is a rule of customary international law. In the *Interhandel* Case, the International Court of Justice stated that:
"The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law; the rule has been generally observed in cases in which a State has adopted the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law. Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic system."[60]

In the *ELSI*-case, the International Court of Justice acknowledged that the local remedies rule may be derogated from, qualified or varied by any binding treaty. However, the Court pointed out that the
"[…] Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an objection to do so."

In this report, it shall be assumed that this rule has a procedural nature only. There has been a long standing debate whether the rule forms a part of procedural law or whether it is a substantive requirement for a breach of international law to exist. It is neither appropriate nor possible to give even a summary of this debate, or to comment on it. Instead, reference shall be made to the summary given by *John Dugard*, Special Rapporteur of the International Law Commission, in his second report on diplomatic protection[61].

However, both the procedural and the substantive aspects of the rule of exhaustion of local remedies have been discussed in recent cases. Consequently, both shall be reviewed.

II. Exhaustion of Local Remedies as a Procedural Requirement

Art. 26 ICSID Convention reads as follows:
"Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."

60 1959 ICJ Reports 27.
61 *Dugard*, Second report on diplomatic protection, ILC 53rd session, UN Doc. A/CN.4/514, pp. 15-32.

Absent an explicit requirement to the contrary – in bilateral investment treaties, national legislation or investment agreements – access to ICSID thus will not require the exhaustion of local remedies. This serves to further the Centre's purpose as a neutral venue for the settlement of investment disputes[62], and also the exclusive character already provided for in the first sentence.

In *Generation Ukraine v. Ukraine*, the Respondent thus fruitlessly argued that the Claimant first had to exhaust local remedies before resorting to ICSID Arbitration. The dispute arose on the basis of the US-Ukrainian bilateral investment treaty (the "BIT"), which did not contain a respective requirement of exhaustion of local remedies. Since Ukraine had given its consent to ICSID arbitration already in the BIT, which was matched by the investor's consent (given by filing the notice of arbitration), the Tribunal considered the reliance on Article 26 ICSID convention to be unfounded[63].

The duty to exhaust local remedies refers only to *legal* remedies. It is considered that this includes judicial remedies before ordinary and extraordinary courts as well as available remedies before administrative bodies. However, the individual is not obliged to exhaust "extra-legal remedies or remedies as of grace" or remedies which are of a discretionary nature[64].

It is considered that local remedies need not be exhausted where they provide no reasonable possibility of an effective remedy[65]. In The *Loewen Group, Inc. and Raymond R. Loewen v. United States of America*[66], the Tribunal put it as follows (para. 168 *et seq*.):

"It is an obligation to exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which he is situated.

169. Availability is not a standard to be determined or applied in the abstract. It means reasonably available to the complainant in the light of its situation, including its financial and economic circumstances as a foreign investor, as they are affected by any conditions relating to the exercise of any local remedy.

170. If a State attaches conditions to a right of appeal which render exercise of the right impractical, the exercise of the right is neither available nor effective nor adequate. Likewise, if a State burdens the exercise of the right directly or indirectly so as to expose the complainant to severe financial consequences, it may well be that the State has by its own actions disabled the complainant from affording the State the opportunity of redressing the matter of complaint. The scope of the need to exhaust local remedies must be considered in the light of these considerations."

62 Cf. *Schreuer*, Preamble Mn. 16-21.

63 *Generation Ukraine, Inc. v. Ukraine*, Case No. ARB/00/9, Award of 16 September 2003 (*Salpius, Voss, Paulsson* (presiding)), paras. 13.1 – 13.6.

64 *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 8; *Brownlie*, Principles of Public International Law, 5th ed., p. 499.

65 *Dugard*, Third report on diplomatic protection, UN Doc. A/CN.4/523, p. 17

66 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America.* Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*), para. 169.

It must be mentioned, however, that the decision then rendered by the *Loewen* Tribunal is not free from criticism[67]. The Tribunal considered that the claimants had not exhausted all available remedies (but settled instead), although an appeal vas virtually impossible and chances for further remedies (such as a Supreme Court review), were considered by experts as exceedingly remote.

Several BIT's contain requirements that the investor must first turn to the local courts and can only after a certain time of pending proceedings initiate arbitration. The purpose of such a rule seems to be similar to the purpose of the rule of exhaustion of local remedies: to give the Respondent state the possibility to redress the wrong done by its own legal system[68]. However, such a rule is, technically speaking, not a requirement of exhaustion of local remedies. Thus, in *Maffezini v. Spain,* in *Siemens v. Argentina* and in *Gas Natural v. Argentina*, the tribunals considered such a rule not to require the exhaustion of local remedies[69].

III. Exhaustion of Local Remedies as a Substantive Requirement for a Breach

As discussed above, the substantive aspect of the exhaustion of local remedies rule is not a procedural requirement, but pertains to the question whether there has been a breach of international law at all. Reviewing recent awards, three different aspects can be differentiated.

1. Denial of Justice

It is generally accepted that a denial of justice requires that the individual has exhausted all reasonable local remedies[70]. The landmark case in this regard is *Loewen v. United States*. The claimants had lost a jury trial in Mississippi and were faced with a judgement over US-$ 500 million. While the tribunal concluded that the court failed to "afford Loewen the process that was due", it also considered "that a court

67 Cf. *Paulsson*, Denial of Justice p. 122-125; *Rubins*, *Loewen v. United States*: The Burial of an Investor-State Arbitration Claim, Arbitration International 21 (2005), p. 1 *et seq*.

68 Cf. *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 2.

69 *Emilio Agustín Meffezini v. The Kingdom of Spain*, Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (*Orrego Vicuna* (presiding), *Burgenthal*, *Wolf*), para. 28*; Siemens A.G. v. The Argentine Republic*, Case No. ARB/02/8, Decision on Jurisdiction of 3 August 2004 (*Rigo Sureda* (presiding), *Brower*, *Bello Janeiro*), para. 104*; Gas Natural SDG, S.A. v. The Argentine Republic*, Case No. ARB/03/10; Decision of the Tribunal of 17 June 2005 on Preliminary Questions on Jurisdiction (*Lowenfeld* (presiding), *Lavarez*, *Nikken*), para. 30.

70 *Paulsson*, Denial of Justice, p. 108.

decision which can be challenged through the judicial process does not amount to a denial of justice at the international level"[71]. It noted that the

"purpose of the requirement that a decision of a lower court be challenged through the judicial process before the State is responsible for a breach of international law constituted by judicial decision is to afford the State the opportunity of redressing through its legal system the inchoate breach of international law occasioned by the lower court decision. The requirement has application to breaches of Articles 1102 and 1110 as well as Article 1105."

It is noteworthy that this purpose is the same which is thought to be the purpose of the procedural rule of exhaustion of local remedies[72].

2. No Breach of International Law by a Decision of a Lower Court?

The *Loewen*-award suggests that the acts of a court of first instance do not normally give rise to the level of an international wrong[73]. For the *Loewen*-Tribunal considered that the requirement of exhaustion of remedies against the decision of the lower court applied not only in cases of denial of justice, but also to alleged breaches of Article 1105 NAFTA (fair and equitable treatment) and Article 1110 NAFTA (expropriation).

It needs to be recalled that each and every court, and not the court system in itself, is an 'organ' of the state, the acts of which can be attributed to the state[74]. A state is responsible for actions of its courts which are in breach of international law[75]. Second, irrespective of the attribution of an act to the state, state responsibility further requires that the act is in breach of international law. Whether a judgement of a lower court, against which an appeal is possible, constitutes a breach of an international obligation, can only be determined with respect to that particular obligation. With regard to a denial of justice, the conduct of a court of first instance does not constitute a breach since, as *Paulsson* describes it, "[t]he obligation is to establish and maintain a system which does not deny justice; the system is the whole pyramid."[76]

71 *Loewen*, para. 153.

72 Cf. *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 2 (citing *Borchard* and *Jiménez de Aréchaga*).

73 *Rubins*, Arbitration International 21 (2005), p. 16.

74 *Cf.* draft Article 4 (1) of the ILC draft Articles on State Responsibility (underlining by author): "The conduct of *any* State organ shall be considered an act of that State under international law, whether that organ exercises legislative, executive judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State."

75 *Paulsson*, Denial of Justice, p. 84-87.

76 *Paulsson*, Denial of Justice, p. 109.

The *Loewen*-holding seems to extend the reach of the 'substantive exhaustion of local remedies' from denial of justice to expropriation and fair and equitable treatment. Whether that holding accurately reflects the state of the law under NAFTA, or general customary international law, deserves further analysis.

3. No Breach of International Law if Local Remedies are Available?

Several awards indicate that certain forms of state conduct might not constitute a breach of an obligation under a BIT as long as local remedies are available to the investor.

In *Feldman v. Mexico*[77], the arbitral tribunal found that although "the Claimant, through the Respondent's actions, is no longer able to engage in his business" as a result of the elimination of a tax rebate on export resales of cigarettes"[78], and although "it is undeniable that the Claimant has experienced great difficulties in dealing with [Ministry] officials, and in some respects has been treated in a less than reasonable manner",[79] the Mexican Government's regulatory actions were, on balance, not equivalent to an expropriation. In declining to find that the claimant's allegations of unlawful administrative actions constituted expropriation, the tribunal took account of the availability of court review of those administrative actions[80].

In *Generation Ukraine v. Ukraine*[81], the claimant alleged that through a series of actions and omissions, the Ukrainian authorities had expropriated his investment in an office building. The tribunal found that due to the lack of seeking local remedies, no expropriation took place:

"20.30 The fact that an investment has become worthless obviously does not mean that there was an act of expropriation; investment always entails risk. Nor is it sufficient for the disappointed investor to point to some governmental initiative, or inaction, which might have contributed to his ill fortune. Yet again, it is not enough for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated virtual expropriation. In such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, not because there is a requirement of *exhaustion* of local remedies but because the very reality of conduct

77 *Marvin Feldman Karpa v. Mexico*, Case No. ARB(AF)/99/1, Award of 16 December 2002 (*Kerameus* (presiding), *Bravo*, *Gantz*).

78 *Id.*, para. 109.

79 *Id.*, para. 113.

80 *Id.*, para. 140.

81 *Generation Ukraine, Inc. v. Ukraine*, Case No. ARB/00/9, Award of 16 September 2003 (*Salpius, Voss, Paulsson* (presiding)).

tantamount to expropriation is doubtful in the absence of a *reasonable* - not necessarily exhaustive - effort by the investor to obtain correction."

In *Waste Management v. Mexico (II)*[82], the tribunal concluded that the alleged breach of a contractual obligation by a state did not constitute a breach NAFTA Article 1105 (fair and equitable treatment)

"116. […] It is true that in a general sense the exhaustion of local remedies is a procedural prerequisite for the bringing of an international claim, one which is dispensed with by NAFTA Chapter 11. But the availability of local remedies to an investor faced with contractual breaches is nonetheless relevant to the question whether a standard such as Article 1105(1) have been complied with by the State. Were it not so, Chapter 11 would become a mechanism of equal resort for debt collection and analogous purposes in respect of all public (including municipal) contracts, which does not seem to be its purpose."

or Article 1110 (expropriation):

"175. The Tribunal concludes that it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the present case the Claimant did not lose its contractual rights, which it was free to pursue before the contractually chosen forum. The law of breach of contract is not secreted in the interstices of Article 1110 of NAFTA. Rather it is necessary to show an effective repudiation of the right, unredressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent."

Other tribunals have reached similar conclusions with regard to contract breaches[83].

The latest decision in this regard is the (non-ICSID) award in *EnCana v. Ecuador*, in which the refusal of a governmental agency to grant tax refunds was at issue. The claimant alleged that the state had expropriated its right to the refunds. The tribunal, relying on the *Waste Management* – award, held that

"In terms of the BIT the executive is entitled to take a position in relation to claims put forward by individuals, even if that position may turn out to be wrong in law, provided it does so in good faith and stands ready to defend its position before the courts. Like private parties, governments do not repudiate obligations merely by contesting their existence. An executive agency does not expropriate the value represented by a statutory obligation to make a payment or refund by mere refusal to pay, provided at least that (a) the refusal is not merely wilful, (b) the courts are open

82 *Waste Management, Inc v. United Mexican States*, Case No. ARB (AF)/00/3, Award of 30 April 2004 (*Crawford, Civiletti, Gómez*), paras. 161-174.

83 *SGS v. Philippines*, Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004 (*El-Kosheri, Crawford, Crivellaro*), para. 163; *Consortium RFCC v. Royaume du Maroc*, Case No. ARB/00/6, Award of 22 December 2003 (*Briner, Cremades, Fadlallah*), Abs. 65: "Pour qu'il y ait droit à compensation if faut que la personne de l'exproprié prouve qu'il a été l'objet de mesures prises par l'Etat agissant non comme cocontractant mais comme autorité publique".

to the aggrieved private party, (c) the courts' decisions are not themselves overridden or repudiated by the State."[84]

D. Summary and Concluding Remarks

Parties are free to include into their arbitration agreements provisions on nationality. In treaty-based investment arbitration, the agreement of the parties is constituted by the dispute settlement offer of the BIT, which is accepted by the investor. State parties have the possibility to include denial of benefits-clauses into the BIT and, by this, to exclude certain groups of investors from the scope of their offer to arbitrate.

The reviewed cases suggests that in determining the nationality of corporations, ICSID Tribunals give deference to any existing agreements of the parties. As long as a tribunal considers an agreement not be incompatible with explicit provisions or with the object and purpose of the ICSID Convention, it will uphold that agreement.

In those cases where nationality was disputed (e.g. *Tokios Tokeles*), the problems arose from the lack of such provisions. Since the ICSID Convention sets only the outer limits for such agreements, it should not be burdened with issues which the parties could and should have regulated for themselves (such as excluding investors which are controlled by host-state nationals). Irrespective of that, several awards indicate that tribunals will not accept mere shells as Claimants. While their reasoning is not entirely consistent, it seems that tribunals interpret into the dispute set-

84 *EnCana Corporation v. The Republic of Ecuador*, LCIA Case No. UN3481, Award of 3 February 2006 (*Crawford* (presiding), *Grigera Naon*, *Thomas*), para. 194. The award was rendered by a majority only. Arbitrator *Horacio Grigera-Naon* dissented sharply: "To require such "substantive" exhaustion of local remedies, consisting of a prior and final determination by the local courts of the host State under its own national law of disputes concerning the entitlement of rights (or denial of such rights) of a foreign investor covered by the Treaty, suggests the existence of a public international law had-and-fast rule, binding on international arbitral tribunals, according to which such rights are localized in the host State, exclusively governed by its own laws and, for that reason, that disputes involving such rights must be previously adjudicated by the courts of the host state under its own laws, before related claims under international law are ripe for decision on the merits at the international level."

tlement offer of a bilateral investment treaty a respective implied prohibition of shell companies as claimants.

The rule of exhaustion of local remedies has little practical relevance as a procedural rule in treaty-based investment arbitration. However, Tribunals have declined to find a breach of BIT-provisions where the investor alleged the non-fulfilment of rights existing under the law of the host state, but failed to seek recourse with (not necessarily exhaust) available local remedies. Investors wishing to submit such a dispute to treaty-based arbitration should thus carefully review whether the respective dispute settlement clause allows for such disputes, or is limited to disputes relating to a breach of the BIT.

The "Foreign Nationality"-Requirement and the "Exhaustion of Local Remedies" in Recent ICSID Jurisprudence

Comment by *Michael Kerling*[*]

A. Introduction

I have been asked to comment on the report "The foreign nationality requirement and the exhaustion of local remedies in recent ICSID Jurisprudence" by Dr. *Richard Happ*. As an in-house counsel of a major German construction contractor my comments will be focused on the rather practical aspects of ICSID and I will mainly concentrate on the experiences of our company within the last four years.

As far as I am informed, our company is still the only German construction company that has ever been involved in ICSID proceedings even though it seems to have been established by recent ICSID Jurisprudence that as a matter of principle a construction project in a foreign state might be considered an investment in the sense of bi- or multilateral investment treaties.

Even though we have considered international arbitration on the basis of bilateral investment treaties in the context of quite a few projects, only two cases have "really made it to Washington" so far. One of these cases is the quite well known case "*Impregilo vs. Pakistan*" – our company has been one of the partners of the respective joint venture. The other case "*Ed. Züblin AG vs. Kingdom of Saudi Arabia*" is for sure less known, mainly because it has been finished through amicable settlement in a very early stage.

B. The "Foreign Nationality"-Requirement and "Treaty Shopping" in Practice: Impregilo vs. Pakistan

The case "*Impregilo vs. Pakistan*" seems at least in parts to be suitable for some further thoughts about the "foreign nationality requirement" already discussed in more detail by my colleague Dr. *Happ.*

As I mentioned earlier, our company has been one of the members of an unincorporated joint venture under Swiss law lead by the Italian contractor *Impregilo*, consisting of *Impregilo*, German *Ed. Züblin AG* and two Pakistani contractors. The dispute arose out of two contracts relating to the construction of hydro-electric power facilities located on the Indus river immediately downstream of the Tarbela

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Dam in Northern Pakistan, that when completed, would increase power generation in Pakistan by 15%.

The joint venture had suffered immense damages through continuous frustration of the contractual dispute resolution instruments (Dispute Adjudication Boards in the sense of the FIDIC Red Book). The frustration went far beyond what might have to be expected in such environment. The Employer, the Pakistan Water and Power Development Authority, not only continuously refused any cooperation with regard to obviously outstanding claims but also acted to the detriment of the joint venture by nominating obviously biased adjudicators and by continuously questioning the credibility of the adjudicators nominated by the joint venture. Thus, a fruitful and reasonable handling of the claims became impossible. On the top of that the situation for a foreign contractor became increasingly difficult due to the consequences of the terrorist attacks of 11th September 2001.

All this lead us to the decision to search for a solution on the international level. Unfortunately, we had to notice that there was no BIT providing for an ICSID clause between the Islamic Republic of Pakistan and the Federal Republic of Germany (the old BIT between Germany and Pakistan, which was signed in 1959, does not contain such a clause and has never been amended accordingly). However, a BIT with an ICSID clause was signed between Italy and Pakistan on 19th July 1997. The joint venture decided to start proceedings on this basis. Of course the joint venture was aware of the jurisdictional problems that this might cause but due to the lack of alternative there was no choice but trying it.

As expected, the jurisdiction "*ratione personae*" was one of the main points challenged by the Islamic Republic of Pakistan ("the Respondent"). The Respondent argued that the Italian Contractor could not pursue claims on behalf of the joint venture because the joint venture lacked legal personality and therefore could not be considered as an entity of foreign nationality in the sense of the ICSID Convention. All partners to the joint venture would rather have to appear on their own behalves. The main counter arguments of the joint venture was the following:

The Italian contractor had to have a possibility to assert the claims on behalf of the joint venture as leader and majority stakeholder in the joint venture for the following reasons: Under the joint venture agreement, the Italian contractor was obligated to distribute any monetary judgement awarded to it in an arbitral proceeding to its joint venture partners according to the respective stakes of the partners in the joint venture. Thus, the only way for the Italian Contractor to obtain its full share in the joint venture would have been for the Tribunal to permit the Italian Contractor to proceed on behalf of the joint venture. Otherwise, the aim of the BIT, which always must be the full protection of the foreign investor, could not be reached.

Unfortunately in its decision on jurisdiction, the Tribunal did not follow this view and considered that the Italian Contractor was not able to pursue claims on behalf of the joint venture. It mainly referred to Article 25(2)(b) of the Convention, which defines as we have heard before, that the investor, who may be either an individual or a juridical person, must not have the nationality of the Contracting State which is a party to the dispute. Referring to the drafting history of the Convention the Tribu-

nal then concludes that an association of individuals or juridical persons does not qualify as a foreign juridical person for the purposes of the Convention. This lead to the conclusion of the Tribunal that the joint venture as a whole was not covered by the BIT.

In the Tribunals view, the Italian Contractor was not able to claim compensation amounting to 100% of the damages suffered by the joint venture: In its view, of the three other joint venture partners 1.) none was a protected investor in the terms of the BIT, (2.) two were not nationals "of another Contracting State" for the purposes of Art. 25(1) of the ICSID Convention. It pointed out that in concluding the BIT with Italy, the Respondent had conferred certain rights exclusively to Italian nationals but not to any other nationals; not to mention Pakistani investors themselves.

The fact that the Italian investor was forced by the joint venture agreement to distribute any awarded sums to the other partners to the joint venture was considered a mere internal contractual problem of the Italian Contractor. It has to be mentioned that the Tribunal declined this argument in only a few words, which we considered as neither convincing let alone satisfying. However, the view of the Tribunal seems to be in line with former ICSID jurisprudence.

Nevertheless, the case, containing some further interesting questions, could be settled shortly after the decision on jurisdiction had been released. At least a part of the damages suffered was compensated, which would most probably not have been the case if the joint venture had not decided to bring the case to international arbitration.

From the point of view of "Treaty Shopping", which was also raised by my colleague Dr. *Happ*, our company drew the conclusion that it might be wise not only to clarify whether a BIT containing an ICSID clause exists before negotiating contracts with public entities abroad but also to choose foreign partners against the background of a possibly existing BIT. Even though it has been established in the above mentioned decision that in a joint venture only partners being nationals of one of the contracting states can claim jurisdiction, it still is a means of pressure to have at least one partner in a joint venture who is able to refer the dispute to ICSID arbitration if any other instrument of reasonable dispute resolution has failed.

C. The "Exhaustion of Local Remedies": Ed. Züblin AG vs. Kingdom of Saudi Arabia

As I mentioned earlier, this case has been settled in such an early stage that probably none of you has even heard of it. I am not sure if I really fully hit the mark of the topic but when drafting our request for arbitration we came at least across some very interesting questions concerning local remedies.

The dispute arose out of the long delay in the rendering of a judgement by the courts of the Kingdom of Saudi Arabia as well as the persistent failure by the Government of the Kingdom of Saudi Arabia to honour a final and binding judgment in favour of our company.

A few words concerning the project and the dispute: On 8th April 1978, King Saud University ("the University") and our company entered into a contract to construct a new academic campus for the University. This contract was substantially completed in May 1986. Continuous failures to comply with its obligations under the contract by the University caused the Contractor to suffer significant damages. Any claims always submitted in accordance with the contract were rejected by the University. The Contractor therefore was compelled to submit these claims to the "Board of Grievances", which was according to the contract to resolve any disputes between the parties. The lawsuit was initiated in 1984. On 12th March 2001, a judgment awarding the contractor more or less what was claimed 17 years before. Our lawyers in Saudi Arabia considered this judgment "most probably final". What had happened during this period of 17 years? In the following a short overview from the time of submitting the points of claim until the issuance of a "final judgment":

- 24th March 1986: first hearing
- no communication and no explanation in the following 6 years
- 3rd March 1992: re-opening of the case due to appointment of new judges
- "final hearings" on 2nd May and 19th October 1992
- no action in the following three years
- re-opening of the case on 14th February 1995
- 19th December 1995: first judgment
- appeal of the University, relegation to Board of Grievances
- 29th September 1997: appointment of a Technical Expert
- 25th January 1999: submission of the report, confirming first judgment
- accusation of the Technical Expert of bribery and forgery by the University
- 5th July 2000: rejection of the accusations by the Investigation Bureau
- 8th October 2000: new judgment ordering the University to pay the claimed amount
- appeal by the University
- 12th March 2001: confirmation of judgment of 8th October.

After the last confirmation of the judgment nobody could really assure us that it was really final. Our company made multiple attempts to obtain the sums awarded but all such attempts failed: All governmental bodies involved had been informed, the request was sent from one authority to the other, but none of the officials involved wanted to make any statement. Our company even referred the dispute to the Royal Court (but this obviously is not a further instance in Saudi judicial system) and to the Saudi General Investment Authority, which was founded in the year 2000 in connection with the new Foreign Investment Law in order to improve the "investment climate" in the Kingdom of Saudi Arabia. Additionally, the German Embassy officially but unsuccessfully raised the issue several times with the Government of Saudi Arabia. Yet, because none of these attempts led to any success and due to the lack of enforcement rules against public entities in the Saudi legal system, we started thinking about ICSID and decided to initiate respective proceedings

against the Kingdom of Saudi Arabia on the basis of the BIT signed between Germany and Saudi Arabia on 29th October 1996.

In the light of such history, the term of "exhaustion of local remedies" became quite of essence for us. It is difficult to establish such exhaustion if it is completely unclear how the local remedies work. For that reason, we had to do some in-depth research on the Saudi judicial system when drafting our request for arbitration and we learnt that the Saudi legal system belonged to the legal systems where it might even be impossible to establish the requirement of exhaustion of local remedies.

There are only very few publications on the Saudi legal system so that we had to rely mostly on information of our local counsels. The Board of Grievances, before which our case was handled, is a very traditional institution dating from the early years of Islam. It was revived by the Saudis in the fifties and today has amongst others exclusive jurisdiction over "cases regarding disputes relative to contracts to which the Government or public juridical person is a party". Judgments usually are not published and the stages of appeal are extremely complicated and thus confusing. Especially in the procedure for disputes between private companies and public entities, there are different stages of "automatic appeal" and endless relegations, which are quite difficult to follow. By all means, in the end, we just had to assume that the local remedies had been exhausted in this case and submitted our request for arbitration on this basis.

Fortunately for us but unfortunately for those dedicated to ICISD jurisprudence a very profitable settlement offer came shortly after the Tribunal had been constituted. This way, many interesting questions have never been dealt with. Another question in this case would also have been the one of the foreign joint venture partner because our company had been the leader of a joint venture with two Swiss partners.

D. Conclusion

Both of our cases show that ICSID arbitration has proven as a successful instrument of pressure for companies involved in multinational projects, when conventional mechanisms of dispute resolution or enforcement of judgements fail. Therefore, from the point of view of an international contractor, it definitely makes sense to verify whether a Bilateral Investment Treaty containing an ICSID clause exists before entering into a contract with a foreign public entity.

The "Foreign Nationality"-Requirements in ICSID Arbitration

Comment by *Anthony C. Sinclair**

This commentary to Dr *Happ*'s paper[1] focuses on the first of his two topics and deals with three essential themes. First, this commentary acknowledges the relationship between the element of consent called for pursuant to Article 25 of the 1965 „Convention on the Settlement of Investment Disputes between States and Nationals of other States" (the "Convention"[2]) and the nationality requirements of any applicable investment protection treaty. Secondly, it emphasises the mandatory requirements of the Convention as to nationality for the „International Centre for the Settlement of Investment Disputes" ("ICSID" or "the Centre") to have jurisdiction and highlights their interplay with requirements to qualify for investment treaty protection. And finally, the commentary conducts a brief and admittedly selective survey of the diversity of approaches to nationality and qualification for protection found in investment treaties, and how these approaches can interact with the objective outer limits of ICSID jurisdiction.

Possession of the nationality of a Contracting State to the Convention is a door through which an investor must pass in order to be able to bring a claim within ICSID's jurisdiction. Article 25(1) of the Convention provides that the jurisdiction of the Centre:

"shall extend to any legal dispute arising directly out of an investment between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally" (emphasis added).

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1 *Happ*, "The Foreign Nationality Requirement and the Exhaustion of Local Remedies in Recent ICSID Jurisprudence", The International Convention for the Settlement of Investment Disputes: Taking Stock after 40 Years, Frankfurt, 26 to 28 April 2006.

2 World Bank Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington D.C. 1965 signed 18 March 1965, in force 14 October 1966, 575 U.N.T.S. 159 reprinted in (1965) 4 I.L.M. 532 and available online at www.worldbank.org/icsid.

Dr *Happ* rightly acknowledges that in practice it is the scope of "consent" that is the key for claimants' standing. For in the vast majority of ICSID cases today, arbitration proceedings stem from a standing generic offer on the part of the host State to arbitrate disputes with qualified foreign investors set out in an investment promotion and protection treaty. Having the nationality of an investor to whom such an offer is made is therefore an essential element in order for the parties' consent to arbitrate disputes to crystallise. Matters of ICSID case law necessarily merge here with questions of qualification arising under investment protection treaties, notwithstanding that strictly speaking it is only the former that is the topic of this conference. It is for this reason, however, that reference may be made to questions of nationality arising both under investment treaties as well as under the Convention. Indeed, many of the most interesting nationality cases of recent years concern nationality for the purpose of ascertaining consent under the applicable BIT, not simply nationality for the purposes of Article 25 of the Convention.

These instruments – the Convention and any applicable investment treaty – present dual requirements for the Centre to have jurisdiction to decide a dispute. A claimant must establish *both* that it meets the nationality conditions in any treaty, as well as the objective requirements of the Convention. The relationship between these is governed by Article 25, which sets the "outer limits" of ICSID's jurisdiction.[3] The majority in *Tokios Tokelės* v. *Ukraine* therefore may well have incorrectly marginalised the requirements of the Convention - express or implied - when it essentially deemed its jurisdiction to be established merely by satisfaction of the criteria for standing under the applicable Lithuania-Ukraine BIT.[4] There is principle behind the majority's approach which many will favour: generally, "an agreement to submit to ICSID's jurisdiction should be upheld unless it would lead to a use of the Convention for purposes for which it was clearly not intended".[5] It is precisely that cautionary proviso, however, that motivated the chairman of the Tribunal to disagree with the majority. *Weil*'s frequently cited dissent – perhaps even more so than the majority decision itself – takes the view that satisfaction of the nationality conditions for jurisdiction to exist under the Convention must be "the first leg of the reasoning".[6] *Weil* opined that although the Contracting Parties to an investment treaty "are free to confer to the ICSID tribunal a jurisdiction narrower than that provided for by the Convention, it is not for them to extend the jurisdiction of the ICSID tribunal beyond its determination in the Convention".[7]

The divergence between the arbitrators in *Tokios* turned on the recurring – and yet to be convincingly resolved – question whether ICSID jurisdiction can extend to a

3 *Broches*, The Convention on the Settlement of Investment Disputes between States and Nationals of other States, (1972-II) 136 Recueil des Cours 331, 361 (hereafter "*Broches*").
4 Decision on Jurisdiction dated 29 April 2004.
5 *Schreuer*, The ICSID Convention: A Commentary (2001), Article 25, para. 464 (hereafter *"Schreuer*").
6 Dissenting Opinion dated 29 April 2004, para. 15.
7 *Tokios*, Dissenting Opinion of Prosper *Weil*, para. 13.

juridical entity incorporated in another Contracting State to the Convention that is owned or controlled by nationals of the host State. As Dr *Happ* has described, the majority in *Tokios* saw no impediment to their jurisdiction in these circumstances once the criteria in the investment treaty were found to be satisfied. Notably, during the drafting of the Convention, a proposal was raised to define standing by reference to the foreign origin of the investment, consistent with the Convention's goal to encourage the international flow of capital. The idea was not pursued[8] and, indeed, in many ICSID cases the fact that funds have been sourced locally has not proved an impediment to ICSID jurisdiction.[9] Although the national origin of capital *per se* may therefore not be relevant to ICSID jurisdiction, the national origin of the controllers of the investment may well be. *Weil* would have declined jurisdiction in the light of the general principle in international law that a national is not permitted to sue its own State in an international forum[10] and the fact that the Convention is concerned with "the need for *international cooperation* for economic development and the role of private investment therein", not the resolution of essentially domestic disputes.[11] Foreshadowing this issue in his Commentary, *Schreuer* admitted to finding the possibility that a national of a host State may seize ICSID of jurisdiction via a corporate vehicle incorporated in another Contracting State "troubling".[12] He believed that "realism" ought to "militate against jurisdiction" where the claimant company is controlled by nationals of the host State:

"[o]n balance, the better approach would appear to be a realistic look at the true controllers thereby blocking access to the Centre for juridical persons that are controlled directly or indirectly by nationals of non-Contracting States or nationals of the host State".[13]

The majority decision in *Tokios* turned on the presumed intention of the Contracting Parties to the Lithuania-Ukraine BIT. The majority's reasoning is relatively less concerned with the objective requirements for jurisdiction to exist under the ICSID Convention. Like *Tokios*, it is also conspicuous that the jurisdictional decision in *Aguas del Tunari S.A.* v. *Republic of Bolivia* contains no explicit discussion as to whether the objective requirements of the ICSID Convention were met in that case, although there is again extensive reference to the requirements of the applicable investment treaty.[14] The Tribunal's decision contains a lengthy treatment of the requirements for an entity to qualify for protection under the Bolivia-Netherlands BIT but no reference to ICSID Article 25(2)(b) even though the claimant was Bo-

8 *Schreuer*, Article 25, para. 427.

9 *E.g.*, *Tradex Hellas S.A.* v. *Republic of Albania*, Award dated 29 April 1999, para. 109.

10 *Ibid*., paras. 5, 10; also *Schreuer*, Article 25, para. 496: "The Convention is designed to facilitate the settlement of investment disputes between States and nationals of other States. It is not meant for disputes between States and their own nationals. The latter type of dispute is to be settled by domestic procedures, notably before domestic courts".

11 Convention, Preamble, para. 1 (emphasis added).

12 *Schreuer*, Article 25, para. 562.

13 *Ibid*., para. 563.

14 Decision on Jurisdiction dated 21 October 2005.

livian.[15] Charitably perhaps, the Tribunal was content *to infer* the exi-stence of an agreement between the parties to treat the Bolivian company, *Aguas del Tunari*, as a national of a foreign Contracting State *because of* foreign control once it had established that it fell within the definition of a Dutch "investor" as set out in the BIT. Admittedly, the Convention requires no special form for such an agreement.[16] *Schreuer* observes, in fact, that "[t]he practice of ICSID tribunals shows an increasing readiness to accept an implicit agreement to treat a juridical person as a foreign national because of foreign control".[17] From that practice, *Schreuer* deduces that "[i]f the investor takes up the offer contained in the … treaty, the provisions on access of locally established but foreign controlled companies become part of the agreement between the parties".[18] This approach is consistent with the universally-accepted construction of an agreement to arbitrate arising from the offer on the part of host States found in modern investment treaties, and the acceptance of that offer by investors at the time they submit a request for arbitration.[19] It also appears to be the approach adopted by the Tribunal in *Aguas del Tunari*. The case is a relatively rare modern example of a question of ICSID jurisdiction potentially turning on the application of Article 25(2)(b). As investment protection treaties are repeatedly confirmed to confer upon the foreign shareholders in local companies both substantive protection and a direct right to submit claims to arbitration for harm suffered to their subsidiaries,[20] recourse to ICSID's jurisdiction for a locally-incorporated entity ceases to depend on the existence of an agreement to treat it as a foreign national.[21] It is therefore unfortunate, for those seeking further clarification of ICSID law, at

15 With respect to legal persons, a national of a Contracting State is defined in Article 25(2) as: "(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention".

16 *Schreuer*, Article 25, para. 504.

17 *Ibid*., para. 510.

18 In this manner, an express agreement is formed: *ibid*., para. 505, also 536 but *cf*. para. 519 where *Schreuer* doubts whether an *implied* agreement on nationality can arise where consent to jurisdiction is based on the host State's legislation or on a treaty: "If the investor simply accepts a standing offer by the host State to submit to jurisdiction, no agreement to treat that particular investor as a foreign national can be imputed to the host State".

19 *E.g.*, *El Paso Energy International Company* v. *The Argentine Republic*, Decision on Jurisdiction dated 27 April 2006, para. 35: "It is now *established beyond doubt* that a general reference to ICSID arbitration in a BIT can be considered as being the written consent of the State, required by Article 25 to give jurisdiction to the Centre, and that the filing of a request by the investor is considered to be the latter's consent" (emphasis added).

20 *E.g.*, *Siemens A.G.* v. *The Argentine Republic*, Decision on Jurisdiction dated 3 August 2004, para. 142: "As regards ICSID law dealing with the issue of the rights of shareholders to bring a claim before an arbitral tribunal, the decisions of arbitral tribunals have been consistent in favor of such right of shareholders".

21 This development is foreshadowed by *Schreuer*, Article 25, para. 520.

least,[22] that the *Aguas del Tunari* Tribunal did not engage in any explicit analysis of the locally-incorporated claimant's *de facto* foreign status for the purposes of Article 25(2)(b).[23]

Aside from the exception in Article 25(2)(b), the Convention provides relatively little elucidation itself on many of the contemporary problems arising from nationality requirements raised in Dr *Happ*'s report. One further exceptional instance of a clear rule in the Convention concerns the standing of a dual national having both the nationality of another Contracting State, as well as the nationality of the host State. In *Champion Trading et. al.* v. *Arab Republic of Egypt*,[24] nationals of the United States who were also found to be Egyptian nationals were denied the right to submit their claims to ICSID on account of the "clear and specific rule" found in Article 25(2)(a).[25] This provision, which had been adopted unanimously by the Convention's drafters, ex-cludes absolutely from ICSID's jurisdiction claims by physical persons who are dual nationals having both the nationality of the host State and nationality of another Contracting State. Schreuer explains that "persons who possess the nationality of another Contracting State are excluded if they possess the host State's nationality concurrently".[26] The rule cannot be bypassed even with the parties' consent and applies irrespective of arguments as to which nationality is the more effective.[27] The Convention is clear in this respect.

The larger question whether the doctrine of dominant and effective nationality, as elucidated by the International Court *Nottebohm*[28] and, for example, applied by the

22 *Ibid*., para. 537.

23 The pre-2000 jurisprudence, based largely on contractual submissions to ICSID's jurisdiction, is discussed in *Schreuer*, *ibid*., paras. 496-607.

24 Decision on Jurisdiction dated 21 October 2003. See also *Shihata/Parra*, "The Experience of the International Centre for the Settlement of Investment Disputes" (1999) 14 ICSID Rev.-F.I.L.J. 299, 308.

25 With respect to physical persons, Article 25(2) defines "National of another Contracting State" to mean:
"(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute" (emphasis added). On the drafting history to this provision, see *Schreuer*, Article 25, para. 442.
Interestingly, the plain wording of Article 25(2)(a) would suggest that physical persons who are stateless will not have standing before the Centre: *Nathan*, ICSID Convention: The Law of the International Centre for the Settlement of Investment Disputes (2000) 84; also *Schreuer*, Article 25, para. 437.

26 *Schreuer*, Article 25, para. 440.

27 *Ibid*., para. 444.

28 *Nottebohm Case* (*Lichtenstein* v. *Guatemala*), Second Phase, Judgment dated 6 April 1955 (1955) ICJ Rep. 4, 22. On the principle of effective nationality see also *Salem Claim* (1932) II R.I.A.A. 1184, 1188; *Mergé Claim* (1955) 22 I.L.R. 443, 456; *Flegenheimer Claim* (1958-I) 25 I.L.R. 91, 149; and *Stankovic Claim* (1963) 40 I.L.R. 153, 155.

Iran-US Claims Tribunal in *Case No. A/18*,[29] is generally applicable to ICSID's requirements remains at large, notwithstanding Dr *Happ*'s view that it "seems … to have been accepted with regard to investment disputes". The question whether the principle of effective nationality has any place in investment treaty arbitration was extensively argued in *Hussein Nuaman Soufraki* v. *United Arab Emirates*, but not decided.[30] It is also adverted to in the *Champion Trading* decision, but again not decided.[31] The drafting history to the Convention suggests that possession of the nationality of a non-Contracting State in addition to that of a Contracting State is not in itself a bar to ICSID jurisdiction over dual nationals.[32] Broches himself suggested in his 1972 Hague lectures that the drafters were not concerned to legislate against such jurisdiction.[33] The question is therefore still undecided, and will no doubt be raised again in future cases,[34] but with the International Law Commission moving away from the *Nottebohm* position,[35] it is by no means clear that the doctrine of dominant and effective nationality will be adopted into ICSID law.

To conclude on the standing of physical reasons to submit claims to ICSID, writing on the scope of investment treaty arbitration in 1962, *Elihu Lauterpacht* (as he then was) considered that "where natural persons are concerned, few difficulties are likely to arise".[36] Claims have been submitted to ICSID by natural persons in at least a dozen cases[37] and, for the most part, *Lauterpacht's* forecast has been fair.

29 Decision No. Dec 32-A18-FT dated 6 April 1984, reprinted in (1984) 5 Iran-US C.T.R. 251, 263.

30 *Hussein Nuaman Soufraki* v. *The United Arab Emirates*, Award dated 7 July 2004, para. 42. Noting the Award, see *Sinclair*, Nationality of Individual Investors in ICSID Arbitration (2004) 7 *Intl. Arb. L. Rev*. 191 (hereafter "*Sinclair* (2004)"). Allen & Overy LLP represented the United Arab Emirates in this dispute and continues to do so in an annulment proceeding, which is still pending at the time of writing.

31 *Champion Trading et al.* v. *Arab Republic of Egypt*, Decision on Jurisdiction dated 21 October 2003, at p. 16.

32 ICSID, Documents Concerning the Origin and Formulation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Vol. I (Washington D.C.: ICSID, 1968) 122 (hereafter "History of the ICSID Convention"); *ibid*., Vol. II, 170, 447.

33 *Broches*, *op cit*.

34 There is also passing reference to the concept in *Feldman Karpa (Marvin Roy)* v. *United Mexican States*, Decision on Jurisdiction dated 6 December 2000, para. 32; and *Olguín (Eudoro A.)* v. *Republic of Paraguay*, Award dated 26 July 2001, para. 18.

35 *International Law Commission* (*Dugard*, Rapporteur), First Report on Diplomatic Protection, UN Doc. A/CN.4/506 (2000) 35; International Law Commission, *Draft Convention on Diplomatic Protection* (2002), Article 5(1) reprinted in *International Law Commission*, Report to the General Assembly, UN Doc. A/57/10 (2002) 166, 182; and also *Orrego Vicuña*, Interim Report to the International Law Association on Diplomatic Protection of Persons and Property, in International Law Associate Committee on Diplomatic Protection of Persons and Property, First Report (2000) at 32-33, 35 (available online at www.ila-hq.org).

36 *Lauterpacht*, The Drafting of Treaties for the Protection of Investment (1962), ICLQ Suppl. No. 3, 18.

37 See the references cited in *Sinclair* (2004), *op cit*.

However, exceptional cases such as *Soufraki* and *Champion Trading* demonstrate that the nationality issues that can arise are not always straightforward.

Just as, given the current state of the law, it cannot be said that the Convention imposes a legal test of "dominant and effective" nationality for physical persons, likewise the Convention contains no express requirement that a juridical person should have any particular connection with the Contracting State in which it is incorporated beyond the fact of incorporation. There is no general doctrine in ICSID law or investment treaty arbitration generally mitigating against jurisdiction where the claimant is a mere "shell", absent a specific limitation to that effect in the applicable treaty. Although it is a UNCITRAL case, remarks in *Saluka Investments B.V.* v. *Czech Republic*[38] are highly relevant and, on this point, had *Saluka* been an ICSID case it is very likely that the Tribunal's conclusions would have been no different. The Czech Republic had argued that Saluka was not a "real Dutch investor" but a mere conduit for an investment by *Nomura*, a UK entity. Although Article 1 of the Czech Republic-Netherlands BIT clearly extended to Saluka, since it was an entity organised in accordance with the laws of the Netherlands, the Czech Republic argued strongly against that being the end of the story and requested that the Tribunal look at the reality of the situation. The Tribunal denied the objection:

"The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure and to practices of 'treaty shopping', which can share many of the disadvantages of the widely criticised practice of 'forum shopping'.

However that may be, the predominant factor which must guide the Tribunal's exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal's jurisdiction. ...The parties had complete freedom of choice in the matter, and they chose to limit entitled 'investors' to those satisfying the definition set out in Article 1 of the Treaty".[39]

Equally, the Convention's drafters chose deliberately not to import any rule that would deny jurisdiction to a juridical person that is a so-called shell, not having any substantial business activities in the territory of the Contracting State in which it is incorporated. To the extent that States may wish to exclude protection for such entities, such jurisdictional choices are, again, matters of consent that may or may not be addressed in any applicable relevant investment treaty.

Accordingly, reviewing the range of approaches in investment treaties to determine whether an investor has the nationality of a Contracting Party one can find a great deal of variation, and rightly so, since different States legitimately may take different approaches to qualification for treaty protection. There is no single appro-

38 Partial Award dated 17 March 2006.
39 *Ibid*., paras. 240-241.

priate link between an entity asserting a right to protection under an investment treaty, and the State under whose treaty the investor is seeking to benefit.[40] Many States bestow their treaty protection liberally, believing, one may surmise, that the reciprocal promotion of investment flows is best achieved by a very flexible and open definition of nationality based on mere formalities alone. On the other hand, a significant minority of States appear to take the view that the economic and developmental goals underpinning their investment treaties are best satisfied by conferring protection only upon entities with a tangible economic link to their country, such as "substantial economic activities", or their "effective management" or "main headquarters".[41] Whichever approach is the more appropriate for a particular State is a question best to be debated by economists and politicians.

Insofar as treaties contain a reference to ICSID jurisdiction, the Convention itself notoriously does not specify any particular test for nationality. The Convention thus accommodates the freedom of States to legislate who may be their nationals and to agree upon these criteria, subject to the objective outer limits of the Convention.

In time, other criteria for standing to submit claims to international fora may be developed, especially as the role of individuals as subjects of international law becomes more widely accepted.[42] For the time being, the necessary qualification to access ICSID is to have the nationality of a Contracting State although it is said that nationality for these purposes is not identical to the concept of nationality in the traditional sense of the link conferring upon a State the right in international law to espouse a claim by way of diplomatic protection.[43] Nationality, for the purposes of ICSID, merely "serves as a means of bringing the private party within the jurisdictional pale of the Centre".[44]

At one time, international investment protection had been fortuitous, but given the breadth of the network of investment protection available today, international law firms routinely advise investors on the strategic structuring of their investments. In doing so, close adherence to the diversity of treaty language is required in order to ensure that an investment benefits from the protection of an effective investment

40 For a detailed study of the tests of corporate nationality, see *Acconci*, Determining the Internationally Relevant Link between State and Corporate Investor (2004) 5 Journal of World Investment & Trade 139.

41 For a survey of the approaches, see *Sinclair*, The Substance of Nationality Requirements in Investment Treaty Arbitration (2005) 20 ICSID Rev.-F.I.L.J. 357 (hereafter "*Sinclair* (2005)").

42 *Schreuer*, Article 25, para. 431.

43 *Broches*, Chairman's Report on the Preliminary Draft of the Convention, 9 July 1964, Doc Z11, History of the ICSID Convention*, Vol. II*, 557, 579 and *Amerasinghe*, The Jurisdiction of the International Centre for the Settlement of Investment Disputes (1979) 19 Indian J. Intl. L. 166, 198, 203 (hereafter "*Amerasinghe*").

44 *Amerasinghe*, 198.

treaty and access to ICSID should a dispute arise.[45] Absent any special treaty limitation, it is not uncommon and apparently not contrary to ICSID jurisdiction to locate a new operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment, including the availability of an investment treaty.[46] Frequently, such structuring takes place in the months, or even weeks, before the crystallisation of a cause of action. This does not mean, however, that an investor of a State that is not an ICSID Contracting State may assign a *ripe* treaty claim to an entity having the nationality of a Contracting State in order to attract ICSID jurisdiction.[47] The Tribunal in *Mihaly International Corp*. v. *Democratic Socialist Republic of Sri Lanka* stated that a treaty claim "under the ICSID Convention with its carefully structured system is not a readily assignable chose in action as shares in the stock-exchange market or other types of negotiable instruments, such as promissory notes or letters of credit".[48] To allow such an assignment to operate in favour of ICSID jurisdiction would defeat the object and purpose of the Convention, as well as the sanctity of the privity of international agreements not intended to create rights and obligations for non-Convention States or their nationals.[49]

45 For example, the notion of "juridical person" in the definition of "national of a Contracting State" is not defined in the Convention but has been held to exclude unincorporated groupings: Schreuer, Article 25, para. 458 and see *Impregilo S.p.A*. v. *Islamic Republic of Pakistan*, Decision on Jurisdiction dated 22 April 2005, paras. 131-139; *Consorzio Groupement LESI-DIPENTA* v. *Republic of Algeria*, Award dated 10 January 2005, para. 40.

46 *Aguas del Tunari*, para. 330.

47 The ICSID Convention requires claimants to establish that they had the nationality of a Contracting State on the date at which the parties consented to ICSID's jurisdiction (and, in the case of natural persons only, also on the date the Request for Arbitration is registered) but does not itself require continuity of nationality, for instance, through to the date of an award: *Schreuer*, Article 25, paras. 452 (natural persons) and 493 (juridical persons). One can therefore agree with Dr *Happ* that, to the extent that a continuous nationality rule may apply at all, it is to be derived not from the ICSID Convention but from any applicable investment protection treaty; *e.g.*, *Loewen Group*, *Inc. and Raymond L. Loewen* v. *United States of America*, Award dated 26 June 2003, para. 220 determining that under NAFTA Chapter 11, the claimant must demonstrate its continuous nationality through to the date of any award. Amongst the commentary on this controversial finding, see *e.g.*, *Paulsson*, Note – *Loewen* v. *United States*, ICSID Additional Facility Case No. ARB/AF/98/3 - Continuous Nationality in *Loewen* (2004) 20 *Arb. Intl*. 213; *Duchesne*, The Continuous-Nationality-of-Claims Principle: Its Historical Development and Current Relevance to Investor-State Investment Disputes (2004) 36 Geo. Wash. Intl. L. Rev. 783; *Mendelsohn*, Runaway Train: The Continuous Nationality Rule from the *Panavezys-Saldutiskis Railway* case to *Loewen* in *Weiler* (ed.) International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Investment Treaties and Customary International Law (2005) chapter 4; *Rubins*, The Burial of an Investor-State Arbitration Claim (2005) 21 Arb. Intl. 1.

48 Award dated 15 March 2002.

49 Where an investor changes his nationality after already enjoying the protection of a BIT on the basis of its former nationality, "it is doubtful that he would continue to be deemed a national of his former country for the purposes of the BIT": *Dolzer* and *Stevens*, Bilateral Investment Treaties (1995) 34.

However, just as investors may structure their activities to benefit from investment treaty protection, so too may different States take steps to limit or avoid claims from entities to which they did not intend to extend the protection of a particular treaty. In addition to defining criteria to qualify for treaty protection, some States insert a so-called "denial of benefits" clause in their treaties that appears to be intended to confer upon host States an absolute right to exclude claims brought by shell or "mailbox" companies. The rationale for the provision may be that such companies are understood not to contribute economically or socially to the fabric of the State in which they are incorporated. Again, whether that actually is the case is a matter for analysis going beyond the scope of this paper.

Plama Consortium Ltd v. *Republic of Bulgaria*[50] is one of the few published cases to date to have addressed the application of such clauses. Plama was a company incorporated in Cyprus, which is a Contracting Party to the 1994 Energy Charter Treaty (the "ECT"). Plama indirectly owned a formerly state-owned oil refinery in Bulgaria through a locally-incorporated company, Nova Plama. When a dispute arose, Plama submitted claims against the Republic of Bulgaria to ICSID, alleging violations of both the ECT and the Bulgaria-Cyprus BIT. Bulgaria sent a letter to ICSID purporting to invoke the denial of benefits provision in Article 17(1) of the ECT and deny to the claimant the substantive protection of the ECT on the basis that: (1) Plama was owned or controlled by nationals of a State that was not a Contracting Party to the ECT; and (2) Plama conducted no substantial business activities in Cyprus. The Tribunal assumed, for the purposes of its analysis, that both requirements of Article 17(1) were met and turned to the question of how Article 17(1) was intended to operate in the context of the ECT as a whole and, specifically, in relation to the generic offer to submit investment disputes to international arbitration set out in Article 26.[51] The Tribunal stated that by operation of Article 26(3)(a) of the ECT and Article 25 of the Convention, the parties had given their unconditional written consent to the arbitration of the dispute. Such consent, once given, may not be unilaterally withdrawn.[52] As such, Article 17(1) of the ECT was congenitally incapable of constituting a bar to the Tribunal's jurisdiction to hear the claims brought under the ECT. As the Tribunal stated, Article 17(1) is not a condition precedent to the offer to submit disputes to investor-state arbitration; it created only a *right* to deny the protection of the ECT.

50 Decision on Jurisdiction dated 8 February 2005. A denial of benefits clause was also considered in *Generation Ukraine Inc. v. Ukraine*, Award dated 16 September 2003.

51 For more extensive discussion, see *Sinclair*, Investment Protection for Mailbox Companies under the 1994 Energy Charter Treaty 5(2) TDM (November, 2005); *Sinclair* (2005) *op cit*.; and *Jagusch/Sinclair*, The Limits of Protection for Investments and Investors under the Energy Charter Treaty in *Ribeiro* (ed.) Investment Arbitration and the Energy Charter Treaty (2006) 73, 93-103.

52 Article 25(1) of the Convention provides: "When the parties have given their consent, no party may withdraw its consent unilaterally".

The Tribunal went on to consider the question whether Article 17(1) could support an objection to the admissibility of Plama's claims on the merits.[53] In the Tribunal's opinion, while Article 17(1) conferred on Bulgaria a right to deny the ECT's protection to mailbox company investors, for that denial to be effective the right had to be exercised: "the existence of a right is distinct from the exercise of that right".[54] More importantly, the Tribunal held that once exercised, any denial of benefits could only apply *prospectively*. It concluded that it would run contrary to the legitimate expectations of existing investors and undermine any certainty for those planning new investments if, once invoked, the right to deny benefits provision could exclude treaty protection for existing investments.[55]

The *Plama* Tribunal's interpretation of the denial of benefits clause presents a number of practical and philosophical difficulties, which have already been described elsewhere, leading some to question its correctness.[56] If correct, however, the effect the *Plama* Tribunal gives to the denial of benefits clause has a number of practical consequences. First, it appears to have left very little scope for host States to invoke denial of benefits clauses, since by the time it becomes aware that a dispute has arisen with a mailbox company investor, it would already be too late. The denial of benefits provision can offer a good defence to claims brought by mailbox companies but a State must exercise its right prior to or at the time of the investment. Conversely, for investors deciding whether to commence arbitration proceedings or for those advising investors on structuring new investments, it is possible to take comfort that if the denial of benefits provision has not already been invoked, it may not be raised subsequently.

By way of a final remark, it is hoped that in conjunction with Dr *Happ*'s report, the foregoing analysis of nationality requirements in ICSID – and investment treaty arbitration – encourages one to share the more uncontroversial view of the *Plama* Tribunal, when it said that:

53 On the distinction between jurisdiction and the admissibility of claims, see *Paulsson*, Jurisdiction and Admissibility in *Aksen*, *Böckstiegel*, *Mustill*, *Patocchi* and *Whitesell* (eds.) *Global* Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of *Robert Briner* (2005).

54 *Plama*, para. 155.

55 *Ibid*., para. 163.

56 See the references cited at footnote 51, above.

"issues as to citizenship, nationality, ownership, control and the scope and location of business activities can raise wide-ranging, complex and highly controversial disputes".[57]

57 *Plama*, para. 149.

State Insolvency – Consequences and Obligations under Investment Treaties

Alexander Szodruch[*]

A. Introduction

With more than 40 pending investor claims challenging Argentina's 2001/2002 pesification measures, it cannot be denied that the topic of this study, though currently being *en vogue*, is somewhat displaced in a "stocktaking" exercise. It is no doubt true that ICSID could very well exist in the absence of proceedings stemming from state insolvency. But it is worth pondering the opposite question: Will ICSID survive *in the presence* of such investor claims? Or, putting it less drastically, does the phenomenon of state insolvency have the potential to change the nature of Investment Treaty Arbitration under ICSID itself? Argentina's fierce opposition to current proceedings and to (possible) enforcement attempts illustrates that Investment Treaty Arbitration could in fact reach an important turning point when faced with claims resulting from situations of state insolvency.[1]

It is interesting to see that although much has been written about the legal implications of the Argentina crisis, there has been a separation between traditional Foreign Direct Investment (FDI) by multinational corporations on the one hand and issues arising from portfolio investment in Argentine public debt (i.e. sovereign bonds issued by Argentina in the 1990s) on the other.[2] The former debate on FDI has largely focussed on questions of ICSID jurisdiction, the interpretation of treatment obligations under BITs and Argentina's plea of State of Necessity, while the discussion on Argentina's record-breaking debt default has centred on how to cope with collective action problems traditionally surfacing in the corporate insolvency setting, the most ambitious plan being the IMF's suggestion for an institutionalized

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1 In particular, states could attempt to terminate Bilateral Investment Treaties (BITs) if they perceive that ICSID Arbitration prevents them from adopting emergency measures designed to escape an economic crisis.

2 For exceptions see *Tietje*, Die Argentinien-Krise aus Rechtlicher Sicht: Staatsanleihen und Staateninsolvenz, Beiträge zum Transnationalen Wirtschaftsrecht, Vol. 37, Feb. 2005, 13-16; *Wälde*, The Serbian Loans Case: A Precedent for Investment Treaty Protection of Foreign Debt, in *Weiler* (ed.), Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law, 2005, 383, 401-423.

Sovereign Debt Restructuring Mechanism (SDRM).[3] This separation reflects the general distinction between the Law of International Investment and the Law of International Finance, the Law of International Trade being the third leg in the triangle called International Economic Law.[4] However, given that Italian holders of defaulted Argentine bonds recently announced to initiate an ICSID claim to recover their losses from the Argentine default,[5] the implications of Investment Treaty Arbitration for sovereign debt restructuring, one of the traditional disciplines of International Financial Law, must no longer be neglected. In fact, as the IMF's SDRM proposal is shelved for the time being due to U.S. opposition,[6] it is legitimate to ask whether Investment Treaty Arbitration under ICSID can serve as an adequate international forum to solve disputes between distressed sovereign borrowers and their private lenders.[7] If ICSID Tribunals turn out to be willing and legally able to hear and decide cases brought by a distressed sovereign's creditors, the nature of Investment Treaty Arbitration could significantly depart from the original ICSID/BIT drafters' intentions.

As a starting point, I will briefly sketch the recent discussion on state insolvency and highlight the important (and partly unresolved) legal issues outside of Investment Treaty law (II.). Part III., the core of the study, will analyze the substantive ICSID/BIT implications and obligations with respect to the phenomenon of state insolvency. Part IV. will address, from an ICSID perspective, two important procedural issues that have frequently arisen in domestic sovereign debt litigation, i.e. the possibility of a temporary stay of proceedings and the prospects of enforcing creditor claims. The concluding Part V. analyzes how Investment Treaty Arbitration can alter the common sovereign debt restructuring process and, turning that very question upside down, how state insolvency claims can change the nature of Investment Treaty Arbitration. The conclusion also contains an assessment whether or not the current BIT/ICSID framework could perform functions of an SDRM and whether

3 *Anne Kruger* (then IMF First Deputy Managing Director), A Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address given at the National Economists' Club Annual Members' Dinner, 26 Nov. 2001, http://www.imf.org/external/np/speeches/2001/112601.htm. The initiative was further elaborated on in the following years, see *IMF*, Proposed Features of a Sovereign Debt Restructuring Mechanism, 12 Feb. 2003, http://www.imf.org/external/np/pdr/sdrm/2003/021203.pdf.

4 *Dolzer*, Generalklauseln in Investitionsschutzverträgen, in *Frowein* et al. (eds.), Negotiating for Peace: Liber Amicorum Tono Eitel, 2003, 291 (293).

5 *Assoziazione per la Tutela Degli Investitori in Titoli Argentini*, Tfa, pronto ricorso a Icsid, 2 March 2006, http://www.tfargentina.it/download/ComunicatoStampaTFA-02_03_2006.pdf. Holders of defaulted Russian debt initiated ICSID proceedings in 1998. The case was reportedly settled, see *Freshfields Bruckhaus Deringer*, The Argentine Crisis – Foreign Investors' Rights, Jan. 2002, 3; *Wälde*, supra note 2, 402 (Fn. 44).

6 *Snow* (then Secretary of the Treasury), Statement at the Meeting of the International Monetary and Financial Committee, 12 April 2003, http://www.imf.org/external/spring/2003/imfc/stte/eng /usa.htm. ("it is neither necessary nor feasible to continue working on SDRM").

7 Debt restructurings with official lenders (states and multilateral institutions) are not covered by ICSID/BITs.

Investment Treaty Arbitration could be reconciled with the overriding principles of state insolvency identified by the IMF.

This study does not contain a current affairs discussion on the Argentina proceedings, tempting as that may be. Still, the Argentina case will quite inevitably be used to illustrate what the legal issues of state insolvency are and how currently pending ICSID proceedings could set important precedents[8] for future cases.

B. Legal Issues of State Insolvency in the Post Brady Age

Much has been written about the legal problems relating to state insolvency in the last years, which is why I will only provide a very brief overview of the core points of the subject matter. The notion of state insolvency hereinafter will refer to the case where a state does not meet (or threatens not to meet) its contractual payment obligations towards foreign nationals located abroad, regardless of whether the state is unable or only unwilling to pay.[9] In the vast majority of cases, these payment difficulties arise regarding payment obligations denominated in a foreign currency (a currency other than the state's own), as the debtor state always has the option to inflate itself out of a domestic currency payment crisis.[10] State insolvency covers all kinds of contractual payment obligations such as debt owed to suppliers and service providers. However, most prominent in the state insolvency context is the debt that states accumulate when tapping international financial markets to finance their expenditures. This is due to the fact that states are more likely to default on classic debt instruments, since the immediate welfare losses are much less significant compared to defaulting on trade credit.[11] Although the ensuing analysis will take heed of this factual practice, it should be kept in mind that state insolvency affects more claims than just those stemming from long term debt securities.

8 Arbitration under ICSID does not follow a *stare decisis* rule, and hence the term "precedent" could be misleading. It will nonetheless be used in an informal sense because ICSID Tribunals are frequently invoking prior ICSID awards as authority for their own decisions.

9 *Borchard*, State Insolvency and Foreign Bondholders, Vol. I. 1951, 115. Admittedly, this is economically inaccurate as the term insolvency only covers the situation where the debtor does not have sufficient funds to pay. However, already drawing a distinction between inability and unwillingness to pay at this definitional stage would confuse the definitional question with the question of whether or not the state actually has the right to refuse payments, see *Ohler*, Der Staatsbankrott, JZ 2005, 590, 593.

10 The Russian default on ruble denominated Russian Law debt obligations (GKOs) in 1998 illustrates that local currency debt is not immune from default either, see *Gelpern/Setser*, Domestic and External Debt: The Doomed Quest for Equal Treatment, 35 Geo. J. Int'l L. 795, 801 (2004).

11 *Samberg*, Debt Restructuring: Trade Finance Falls from Favour, Int'l Fin. L. Rev. Sept. 2002, 21, who notes that the traditional pattern of sparing trade creditors from restructuring is changing.

The most important feature that renders the problem of state insolvency so complex is the fact that sovereign debt is now mainly issued in the form of bonds that are freely traded on securities exchanges. This constitutes a remarkable departure from sovereign financing through syndicated bank loans in the 1970s/80s and can be traced back to the 1989 *Brady*-plan (named after then U.S. Secretary of the Treasury *Nicholas Brady*) that swapped bank debt for tradable debt securities.[12] Moreover, throughout the 1990s, many emerging market countries issued new debt securities to a variety of receptive investors, including retail investors. This development dramatically changed the sovereigns' foreign creditor base from a limited number of large western commercial banks to millions of investors ranging from U.S. Hedge Funds to Italian retirees and German dentists.[13]

What is important from a legal point of view is that sovereign bonds are (undisputedly) private law instruments that contain express (and valid) choice of law clauses,[14] mostly declaring the law of the place of issuance applicable, i.e. the law of New York or the U.K., with Japanese and German law having a much smaller share.[15] On the other hand, we are only recently witnessing states issuing debt instruments under their own laws that are open for foreigners to buy. Another significant feature of foreign law debt instruments are waiver of immunity clauses whereby the debtor state unequivocally submits to the jurisdiction of foreign courts and *ex ante* waives any immunity defences.[16] These contractual provisions already highlight a fundamental difference to traditional FDI where the investment contracts are often governed by the law of the host state and contain choice of forum clauses in favour of the local courts of the host state. Presumably, this reflects both a difference in bargaining power on the part of the foreign investors as well as the more territorial nature of the FDI contracts. Debt securities are not as easily associated with a domestic legal order as, say, the construction of a factory on foreign soil.

12 *Buckley*, The Facilitation of the Brady Plan: Emerging Markets Debt Trading from 1989 to 1993, 21 Fordham Int'l L. J. 1802, 1804-1818 (1998).

13 *Fisch/Gentile*, Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring, 53 Emory L. J. 1053, 1070 ff. (2004).

14 *Siebel*, Rechtsfragen Internationaler Anleihen, 1997, 191.

15 In September 2005, 63% of the outstanding emerging market debt (USD 264 bn.) was governed by New York law, 29% (USD 120 bn.) by English law, 5% (USD 20 bn.) by German law and 3% (USD 12 bn.) by Japanese law, *IMF*, Progress Report on Crisis Resolution, 21 Sept. 2005, 15. http://www.imf.org/external/np/pp/eng/2005/092105.pdf.

16 This is in line with most legal systems that adhere to the restricted theory of state immunity and consider debt instruments acts *iure gestionis*, *Reinisch*, Anm. zu LG Frankfurt Judgment of 14 March 2003, JZ 2003, 1013, 1014 with further references.

II. The Current Restructuring Process

Despite a long history of ideas to form an institutionalized sovereign debt mechanism, such a mechanism is still lacking. Debtors and creditors have so far looked for alternative avenues to find acceptable solutions for state insolvencies. It is interesting for our later analysis to observe that debtor states have employed different restructuring techniques depending on whether the debt instruments were governed by foreign law or by the law of the debtor state.

In cases of foreign law debt, restructuring has largely meant that – in some cases after negotiating with a creditor committee – the debtor makes an offer to its creditors to swap its old debt claims for new ones that contain more favourable terms for the debtor (such as extended maturity, reduced interest or in some cases also debt relief in the form of decreased principal payments). Some of these restructurings have been pre-emptive, i.e. before a cessation of payments (an event of default) occurred, while others such as Ecuador (2000) and Argentina (2005) have been post-default restructurings.[17] Much ink has been spent on whether collective action problems could be mitigated by allowing a majority of creditors (say 75%) to bind a minority that is unwilling to accept a swap offer (the holdout creditors) and how corresponding contractual clauses could be drafted. At the time of writing this paper, drafting practice in New York embraces such a contractual approach and incorporates Collective Action Clauses (CACs), already a common feature in English and Japanese law bonds, into sovereign bonds.[18] Although recent experience with the Uruguayan restructuring 2003 is positive,[19] it remains to be seen whether or not CACs will actually be an effective tool for more orderly debt restructurings. Regardless of recent developments in drafting practice, there is still a large stock of foreign law debt outstanding that does not allow for majority restructuring, meaning that only those bondholders who accept a debt swap offer will be bound by the restructuring terms.[20]

Contrary to the debt swap methods employed to restructure foreign law debt, states have occasionally made use of their law making powers to restructure domestic law debt. They adopted laws amending the terms of the debt or the modes of debt servicing, irrespective of whether these debt instruments were held by domestic or

17 See *Fisch/Gentile*, supra note 13, 1069 f.

18 For a coherent analysis of recent market practice see *Drage/Hovaguimian*, Collective Action Clauses: An Analysis of Provisions Included in Recent Sovereign Bond Issues, Financial Stability Review by the Bank of England, Nov. 2004, http://www.bankofengland.co.uk/publications/fsr/2004/fsr17art9.pdf. German law bonds still do not contain CACs as counsel to the issuers and underwriting banks fear that such clauses could be struck down on consumer protection grounds, see *Schneider*, Die Änderung der Anleihebedingungen durch Beschluss der Gläubiger, in *Baums/Cahn* (eds.), Die Reform des Schuldverschreibungsrechts, 2004, 69, 87.

19 *Steneri*, Uruguay Debt Reprofiling: Lessons from Experience, 35 Geo. J. Int'l L. 731, 748 (Fn. 31) (2004).

20 In June 2005, 47% of outstanding emerging market foreign law debt did not include CACs, *IMF*, supra note 15, 3.

foreign creditors. Russia in 1998 serviced the GKOs held by foreigners into blocked accounts, the proceeds being convertible into dollars only on a very restricted basis. Argentina took a more drastic step in 2002 when it unilaterally converted domestic law dollar bonds into peso debt.[21] It strikes the eye that these coercive restructurings could give rise to Investment Treaty claims.

III. Sovereign Debt Litigation

As the creditor group in the post-Brady age is much more heterogeneous than in the 1980s, the recent debates highlighted the (perceived) threat that creditors would no longer behave as a group acting in the common interest but would rush to the courts and recover as much from their debt holdings as possible, thereby obstructing an orderly debt restructuring process. The case of Argentina where creditors took to the courts in multiple jurisdictions such as Italy, Germany and the U.S. (where a court certified the first class action suit against a sovereign state)[22] could serve as proof that the "rush to the courthouse"-threat is real. However, other debt restructurings, even highly controversial ones such as Ecuador in 2000,[23] have not seen creditor litigation, let alone an asset-grabbing race.

The success of holdout creditor litigation in domestic courts has largely depended on where they brought suit. New York courts (the most prominent forum given the choice of forum clauses in most debt instruments) have generally ruled in favour of the creditors, rejecting sovereign defences such as the Act of State Doctrine or the famous Art. VIII (2) (b) of the IMF Agreement.[24] In Germany, there is still a case pending before the Federal Constitutional Court (*Bundesverfassungsgericht*) on whether Argentina can invoke a public international law State of Necessity defence,[25] and in April 2005 the Italian *Corte di Cassazione* held that Italian courts lacked jurisdiction to hear bondholder claims against Argentina on the principle of

21 See *Gelpern/Setser*, supra note 10, 802-803, 806.

22 *Debevoise/Orta*, The Class Action Threat to Sovereign Workouts, Int'l Fin. L. Rev July 2003, 41-44.

23 Ecuador made use of a coercive restructuring technique borrowed from U.S. corporate restructuring known as exit consents, see *Buchheit/Gulati*, Exit Consents in Sovereign Bond Exchanges, 48 UCLA L. Rev., 59-84 (2000). The technique was only recently validated, *Greylock v. Mendoza*, No. 04 Civ. 7643 (HB), 2005 U.S. Dist LEXIS 1742 (S.D.N.Y. 7 Feb. 2005), aff'd *Greylock v. Mendoza*, No. 05-1414-CV, 2006 U.S. App. 1501 (2nd Cir. 18 Jan. 2006).

24 *Allied Bank International et. al. v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 520-522 (2nd Cir. 1985). For an Argentina case see *Lightwater Corp. et. al. v. Argentina*, No. 02 Civ. 3804, 3808, 5932 (TPG), 2003 U.S. Dist. LEXIS 6156 (S.D.N.Y. 14 April 2003), 11. *Libra Bank v. Banco Nacional de Costa Rica*, 570 F.2d 870, 900 (2nd Cir. 1983).

25 See *inter alia* the request for a preliminary ruling (Vorlagebeschluss) by OLG Frankfurt/M. NJW 2003, 2688.

par in parem non habet jurisdictionem, holding that the Argentine default was an act *iure imperii* that Italian courts could not sit in judgment over.[26]

Even where creditors obtained a judgment in their favour, they have largely been unable to actually collect on it.[27] This is due to the traditional international law concept of immunity from enforcement which prevents creditors from attaching assets used for *iure imperii* purposes.[28] As states are eager not to park commercial assets abroad,[29] payment awards are little useful at the end of the day. In 2000, the notorious decision of the Brussels Court of Appeals in *Elliott v. Peru*[30] suggested that holdout creditors had ultimately overcome the classic enforcement dilemma as it enabled them to stop the debt swaps with those creditors willing to tender their old bonds. However, recent U.S. court judgments[31] and a subsequent ruling of that very Brussels Court[32] indicate that the Elliott-jurisprudence was very short lived and that the old obstacles to enforcement remain. Enforcing debt claims in the debtor state itself seems unlikely at best. Local enforcement authorities are not obliged to enforce foreign court judgments in the absence of a Treaty obligation. Even where a Treaty on the recognition and enforcement of judgments exists, it is subject to a public policy review by local authorities.[33]

Where foreign investors have sued on their domestic law bonds in the debtor state's courts, they have largely been unsuccessful as the courts applied the domestic emergency laws over the principle of *pacta sunt servanda*.[34]

26 Corte Suprema di Cassazione, Sezioni Uniti Civili, 21 April 2005, Docket No. 11225/05 (on file with author). For an English brief see *Cleary Gottlieb Steen Hamilton*, Argentina in Italian Supreme Court Win in Bond Payment Suspension Suit, News Bulletin 27 May 2005, http://www.cgsh.com/english/news/NewsDetail.aspx?id=2523.

27 *Gelpern*, What Bond Markets Can Learn from Argentina, Int'l Fin. L. Rev. April 2005, 19, 21.

28 Whether or not the far reaching immunity waiver clauses also waive immunity from attaching *iure imperii* assets is a question in the pending German BVerfG proceedings, see *Pfeiffer/Kopp*, Der Imunitätsverzicht in Staatsanleihen und seine Reichweite, 102 ZVglRWiss 563-573 (2003).

29 One of the popular cases was Argentina's president *Kirchner* cancelling a visit to Germany, fearing attachment of his presidential aircraft, see Handelsblatt, Tango-König verzichtet auf Tango, 13 Oct. 2003 (No. 196), 21.

30 Het Hoef van Beroep de Brussel (8ste Kamer), 26 Sept. 2000, Docket No. 2000/QR/92 (on file with author).

31 *EM Ltd. et al. v. Argentina*, No. 05-1525-cv, 2005 U.S. App. LEXIS 8599 (2nd Cir. 13 May 2005).

32 See Latin Finance, Nicaragua Beats the Vultures, June 2004, 38.

33 As to the possibility of enforcing German judgments in Argentina see *Baars/Böckel*, Argentinische Auslandsanleihen vor Deutschen und Ausländischen Gerichten, ZBB 2004, 445, 463.

34 For litigation as a result of the 1998 Russian default see *Nadmitov*, Russian Debt Restructuring – International Finance Seminar, 27, http://www.law.harvard.edu/programs/pifs/pdfs/Alexander_nadmitov.pdf. As to the proceedings in Argentine courts on the pesification of domestic law debt see *Baars/Böckel*, supra note 33, 462.

C. Bilateral Investment Treaty Obligations and ICSID

The above analysis of recent state insolvency cases shows that in the restructuring process, the debtor state is in a much stronger position than the creditors, especially since the prospects for enforcement remain slim. This difference in bargaining power necessarily affects the outcome of restructuring negotiations, as the creditors do not have much leverage against the debtor, the times of gun-boat diplomacy to enforce private party claims (luckily) being long gone. We will now assess whether Investment Treaty Arbitration under ICSID has the potential to shift power to the creditors and provide them with more leverage in debt restructurings.

I. Applicability of BITs to Sovereign Debt

It is noteworthy that debt instruments traditionally lack arbitration clauses and instead refer disputes between the parties exclusively to domestic courts.[35] Hence, the only way for ICSID to come into play lies in the respective BIT clauses. This raises the question whether the specific treatment obligations are applicable to sovereign debt in the first place.

1. Ratione Materiae

There is reliable authority for the assumption that the traditionally broad investment definition of Art. 25 ICSID encompasses loans and bonds, whether issued by private or public entities.[36] Interestingly, no state has thus far made use of Art. 25 (4) ICSID to exempt sovereign debt disputes from ICSID Arbitration.

The more precarious question is whether the debt instruments are investments in the meaning of BITs. So far, we have not seen a coherent practice on this question. Some investment protection instruments such as the E.U.-ACP Investment Principles[37] or the Italy–Argentina BIT[38] expressly include public debt held by nationals of

35 *Ebenroth/Dillon*, Arbitration Clauses in International Financial Agreements, 10 J. Int'l Arb. 5, 22 (1993). Recent commentators have promoted the inclusion of ICSID arbitration clauses in sovereign bonds, *Griffin/Farren*, How ICSID Can Protect Sovereign Bondholders, Int'l Fin. L. Rev. Sept. 2005, 21-24.

36 *Fedax v. Venezuela (Decision on Objections to Jurisdiction)*, Case No. ARB/96/3, 37 I.L.M. 1384 (1998), para. 29. *Delaume*, ICSID and the Transnational Financial Community, 1 ICSID Rev. – F.I.L.J., 237 (1986), 242, referring to the drafting history of the Convention.

37 Council of the European Communities: „Community Position on Investment Protection Principles in the ACP-States", ACP-CEE 2172/, 3 Nov 1992, 5.

38 http://www.unctad.org/sections/dite/iia/docs/bits/italy_argentina_it.pdf, Art. 1 lit. c.

the other state party. Also, the recent U.S.-Uruguay BIT[39] indicates that the U.S. government regards public debt as a covered investment. On the other hand, the Canadian Model BIT[40] expressly excludes public debt instruments. Other treaty clauses are rather ambiguous and open to interpretation. The Tribunal in Fedax in 1997 decided that promissory notes issued by a state were covered by the notion of "Titles to Money" in the Netherlands-Venezuela-BIT.[41] The Tribunal drew an express analogy to the issuance of long term debt instruments such as bonds and loans which it implicitly assumed would no doubt qualify as "Titles to Money" as they would serve to finance the country's needs.[42] Taking *Fedax* as precedent and combining this with a number of BITs that expressly cover public debt, we cannot but conclude that sovereign debt will qualify *ratione materiae* as investments for the sake of BIT Arbitration unless there is an express opposite treaty provision.

2. Ratione Loci

One possible objection to the application of BITs could be that financial instruments such as bonds or syndicated loans are not made "in the territory" of the debtor state as required by most BITs.[43] The difficulty with applying this "territoriality criterion" to sovereign debt is that financial instruments, as opposed to traditional FDI, are intangible and that therefore the *situs* of the investment is difficult to determine. Indeed, it would not seem too far off to argue that a sovereign bond, traded on the NYSE, payable on a U.S. bank account, governed by New York law and purchased from a U.S. broker/dealer is not an investment "in the territory" of the debtor state. However, both recent BIT- and (even more so) ICSID jurisprudence are abundantly clear that such objections will not be sustained. The 2004 BIT between the U.S. and Uruguay, which maintains the territoriality criterion, implicitly acknowledges that debt instruments governed by New York law do fall within the ambit of the BIT.[44] And the Fedax Tribunal expressly states that the *situs* of a debt instrument (wherever it is) is irrelevant, as long as "the funds made available are utilized by the beneficiary of the credit …so as to finance its various governmental needs".[45] The Tribunal in *CSOB* adopts a similar approach, holding that the "in the territory"-requirement is satisfied where the investment is designed to benefit the economic

39 Treaty between the U.S.A. and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, Annex G, http://www.unctad.org/sections/dite/iia/docs/bits/US_Uruguay.pdf.

40 http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf, 4.

41 *Fedax v. Venezuela (Jurisdiction)*, supra note 36, paras. 30 ff.

42 *Id.*, at 1386.

43 See U.S. Model BIT Nov. 2004, Preamble ("… investment in the territory of the other Party…"), http://ita.law.uvic.ca/documents/USmodelbitnov04.pdf.

44 U.S.-Uruguay BIT, supra note 39, Annex G, 54.

45 *Fedax v. Venezuala (Jurisdiction)*, supra note 36, para. 40.

development of the receiving state, even where the investment is made in an entirely intangible form (such as a loan).[46] This also implies that there is no distinction between domestic law debt and foreign law debt, an important difference to the SDRM proposal that expressly excluded domestic law debt.[47]

3. Ratione Personae

Although public debt instruments often fall within the ambit of a BIT *ratione materiae*, the *ratione personae* scope of BITs, i.e. the question which investors actually benefit from the BIT guarantees, illustrates that BITs are primarily designed for FDI and not so much for portfolio investment. The typical BIT/ICSID yardstick is the nationality of the investor. In the area of traditional FDI, where the investment cannot easily be transferred from one investor to the other, this might be adequate a standard. By contrast, the nationality criterion could prove inappropriate in globalized financial markets where the investment (public debt) is traded on secondary markets and can freely change hands from one national to the other within seconds.[48] Strictly applying the nationality criterion could lead to the undesirable result that the investment would be granted different legal protection depending on who the holder is. This could not only prejudice the fungibility of the debt instruments[49] but would also run counter to the fundamental principle in sovereign debt restructuring that requires holders of similar claims be granted similar treatment.[50] Admittedly, most favoured nation (MFN) clauses in BITs could mitigate this problem and level the playing field with regard to certain treatment obligations (i.e. if some BITs of the debtor state contain umbrella clauses, while others do not, even those nationals who would not at first glance benefit from the umbrella clause could

46 *Ceskoslovenska Obchodni Bank v. Slovakia* (Decision on Objections to Jurisdiction), Case No. ARB/97/4, 14 ICSID Rev. – F.I.L.J. 251 (1999), para. 88. The Tribunal in SGS v. Pakistan (Decision on Objections to Jurisdiction), Case No. ARB/01/13, 18 ICSID Rev. – F.I.L.J. 307 (2003), para. 136, held that the "injection of funds into the territory" suffices. However, the context of this case was different as it related to the opening of offices in the host state. In *SGS v. The Philippines* (Decision on Objections to Jurisdiction), Case No. ARB/02/6, reprinted in *Crawford/Lee/E. Lauterpacht* (eds.), ICSID Reports, Vol. 8 2005, para. 110, the Tribunal noticed that Fedax had adopted a "very broad definition of territoriality" (Fn. 41). Whether the SGS decisions support the broad Fedax notion of territoriality, *Alexandrov*, The "Baby Boom" of Treaty-based Arbitrations and the Jurisdiction of the ICSID Tribunals, 4 LPICT 19, 47 (2005), is doubtable against this background.

47 *IMF*, supra note 3, 23.

48 The Tribunal in Fedax implicitely acknowledged this consequence, see *Fedax v. Venezuela (Jurisdiction)*, supra note 36, para. 40 ("the identity of the investor will change with every endorsement").

49 As to the fundamental value of fungibility, see *Kümpel*, Bank- und Kapitalmarktrecht, 3rd ed. 2004, 1417.

50 *Clark*, Sovereign Debt Restructurings: Parity of Treatment between Equivalent Creditors in Relation to Comparable Debts, 20 Int'l L. 857, 858 (1986).

invoke such a clause relying on MFN in "their" BIT).[51] Nonetheless, it is much more debatable whether MFN clauses can remedy a situation when the *ratione materiae* scope of BITs varies, i.e. when one BIT does cover public debt (U.S.) while the other does not (Canada). Tribunal practice suggests that MFN clauses cannot broaden the scope of BIT protection because the other BITs are *res inter alios acta* in this respect.[52] To the contrary, it is has been argued that MFN clauses actually do entitle investors to choose the most favourable investment definition from all BITs the opposing state party has concluded.[53] In a setting where a Canadian investor holds debt issued by a state that has BITs with both the U.S. and Canada, an ICSID Tribunal would have to reach a decision on this difficult question. These problems arise whenever portfolio investments are covered by BITs, sovereign debt only being one instance where the *ratione personae* problem could surface.

II. Contract Claims v. Treaty Claims and the Umbrella Clause

Our next issue will be of fundamental importance for the outcome and in fact for the very nature of ICSID-state insolvency cases. The more regrettable it is that ICSID-decisions are very difficult to predict on the topic: The relationship between contract and treaty claims and the meaning of umbrella clauses. While the problem already causes permanent controversy in the classic FDI setting, it is aggravated in the state insolvency context. It will be remembered that sovereign bonds, the investments of primary interest here, certify contractual obligations by which the debtor promises to pay a certain amount of money on a specific date with a fixed (or floating) interest rate. In contrast to the recent ICSID cases that sparked the debate on contract/treaty claims, the contract claim against the host state is not part of a larger operation (such as a concession contract for providing services): The contractual claim is the investment itself. Therefore, it does not come as a surprise that the exact elaboration on the relationship between contract and treaty claims will be the core task for any ICSID Tribunal in future state insolvency cases. A full-fledged analysis of this topic would certainly exceed the scope of this study,[54] so I will restrain myself to highlighting the consequences of the different approaches for our subject of interest.

51 The application of umbrella clauses through MFN clauses was addressed but left undecided in *Impregilo S.p.A. v. Pakistan (Decision on Jurisdiction)*, Case No. ARB/03/3, 22 April 2005, para. 223, http://www.worldbank.org/icsid/cases/impreglio-decision.pdf.

52 *Maffezini v. Spain (Decision on Objections to Jurisdiction)*, Case No. ARB/97/7, 16 ICSID Rev. – F.I.L.J. 212 (2001), para. 45. *Impreglio v. Pakistan*, supra note 51, para. 223.

53 *Rubins*, The Notion of Investment in Investment Treaty Arbitration, in Horn (ed.), Arbitrating Foreign Investment Disputes, 2004, 322-323.

54 For recent analyses see *Shany*, Contract Claims v. Treaty Claims, 99 Am. J. Int'l L. 835-851 (2005). *Cremades/Cairns*, Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes, in *Horn* (ed.), supra note 53, 325-351. *Gaillard*, Investment Treaty Arbitration and Jurisdiction over Contract Claims – The SGS Cases Considered, in *Weiler* (ed.), supra note 2, 325-347.

Although each individual case depends on the wording of the applicable BIT, two general approaches in ICSID jurisprudence can be identified, recently described as integrationist and disintegrationist.[55]

The "integrationist Tribunals" in *Fedax*,[56] *SGS v. Philippines* and most recently *Eureko* and *Noble Ventures v. Romania*[57] interpret BIT umbrella clauses to elevate any contractual investor claim against the state to treaty claim status. Consequently, under this approach, every breach of contract amounts to a breach of the treaty. A sovereign default would, subject to possible defences under domestic and international law, amount to a treaty violation. The "integrationists" would thus do away with the long standing view in international law that the non-payment of public debt, although being a breach of contract, is not an international wrong.[58] From a procedural point of view, "integrationist Tribunals" would have to deal with choice of forum clauses in the debt instruments and assess whether they should follow the (2:1) decision in *SGS v. Philippines* and defer the determination of breach of contract to domestic courts to avoid parallel proceedings.[59]

"Disintegrationist Tribunals" interpret umbrella clauses in a more restrictive manner and draw a distinction between contract claims arising under municipal law and treaty claims arising under the BIT. Under this approach, which seemed to prevail until *Noble v. Romania*, breaches of contract do not constitute treaty violations unless the state makes use of its governmental (*iure imperii*) powers to interfere with the contractual rights of the investor.[60] It is argued that breaches of contract are the commercial risk, a risk that BITs do not seek to insure against. For state insolvency cases, this line of argumentation would have implications fundamentally different from the "integrationists": ICSID Tribunals will not decide disputes where the only issue is that a state missed due payments under a debt instrument: The non-payment

55 *Shany*, supra note 54, 844.

56 *Fedax v. Venezuela (Award)*, Case No. ARB/96/3, 37 I.L.M. 1391, 1396 (1998).

57 *SGS v. Philippines (Jurisdiction)*, supra note 46, para. 116, 117, 127. *Eureko B.V. v. Poland (Partial Award)*, Ad hoc Arbitration, 19 Aug. 2005, paras. 244 ff., http://ita.law.uvic.ca/documents/Eureko-PartialAwardandDissentingOpinion.pdf. *Noble Ventures v. Romania*, ICSID Case No. ARB/01/11, 5 Oct. 2005, para. 54, http://ita.law.uvic.ca/documents/Noble.pdf.

58 *García-Amador*, Second Report on State Responsibility, UN Doc. A/CN.4/106, I.L.C. Yb. 1957-II, 117. *Borchard*, supra note 9, 118-120. That view was also widely shared during the negotiations for the multilateral Agreement on Investment (MAI), see *OECD*, The Multilateral Agreement on Investment – Commentary to the Consolidated Text, 22 April 1998, OECD Doc. DAFFE/MAI(98)8/REV 1, 23.

59 *SGS v. Philippines (Jurisdiction)*, supra note 46, para. 155 and Declaration by Arbiter *Crivallero*.

60 *CMS v. Argentina (Award)*, Case No. ARB/01/8, 44 I.L.M. 1205 (Sept. 2005), para. 299. *Impreglio v, Pakistan*, supra note 51, para. 260. *Joy Mining v. Egypt* (*Award on Jurisdiction*), Case No. ARB/03/11, 44 I.L.M. 73 (Jan. 2005), paras. 77-82. *SGS v. Pakistan*, supra note 46, paras. 165 ff. On the even more restrictive general principle of international law, see Restatement (Third) of the Law, § 712 (1987).

of one's debt is an act *iure gestionis*[61] and constitutes the commercial risk that a creditor is aware of when purchasing emerging market debt (which often yields spectacular returns). ICSID would have to assess whether the government, in one way or the other, invokes its genuine *iure imperii* powers to justify non payment.[62]

The importance of the contract claims/treaty claims question cannot be overstated. Depending on whether ICSID Tribunals will adjudicate over pure contractual disputes or constrain themselves to mere treaty claims, the nature of the proceedings will vary significantly. Both options bear their own problems. An "integrationist Tribunal" would stigmatize a mere non-payment as an international wrong and politicize sovereign debt restructurings.[63] Moreover, it would (arguably) run the risk of being abused as an enforcement tool for domestic court decisions. The latter concern holds particularly true if one subscribes to the *SGS v. Philippines* Tribunal's view that whenever a local judge rules in the investor's favour, compliance with this judgment becomes a treaty obligation.[64] "Disintegrationist Tribunals" would have to address the highly complex question of the extraterritorial effect of *iure imperii* acts, the issue we will turn to next.

III. Extraterritorial Application of Emergency Laws

The distinction between *iure imperii* and *iure gestionis* acts is certainly of some helpful guidance in the context of traditional FDI where the investor enters the host state's territory and subjects its investment to the laws of that state. However, in the context of external public debt, where it is often the state that subjects itself to the laws of some other country upon the express request of the investor,[65] the distinction of *iure imperii* and *iure gestionis* acts gives rise to the problem of the extraterritorial application of domestic laws (conflicts of public law norms). How can a sovereign debtor ever assume *iure imperii* powers to interfere with an investment (and thereby trigger a treaty claim) when the investment is exclusively governed by the laws of the State of New York, is to be repaid in New York on an account with a New York bank?

The general question of the extraterritorial application of domestic laws is certainly one of the most disputed fields in International Economic Law, and scholars of private international law even deny that it is a matter of public international law at

61 Mixed Tribunal of Cairo, 15 June 1925, stating that "the refusal to pay … has never been an act of sovereignty, or an act of public authority, because any private individual may do the same. The mere fact that the debtor is a state can make no difference", quoted after *Borchard*, supra note 9, 11 (Fn. 7).

62 *Wälde*, supra note 2, 408.

63 Especially regarding the diplomatic tools in the hands of the creditors' home governments, see infra. IV. 2.

64 *SGS v. Philippinies (Jurisdiction)*, supra note 46, paras. 127, 128, 163.

65 See supra II. 1.

all.[66] However, when faced with an investment dispute, ICSID cannot help but make a decision.

1. Domestic Law Debt

The situation of domestic law debt in this regard appears to be less complex than foreign law debt as it resembles the traditional FDI situation where the foreign investor submits to the laws of the debtor state. Let us assume *arguendo* that the choice of domestic law renders the sovereign competent to amend its laws and thereby affect its debt servicing obligations towards foreigners.[67] If the state actually makes use of this competence, this exercise of classic *iure imperii* powers will be tested against the state's obligations under international law (i.e. BITs).[68] One possible argument for the debtor state could be that the creditor assumed the risk by voluntarily submitting to the local laws and receiving a higher risk premium as compensation and therefore acts in bad faith bringing an ICSID claim. It is unlikely that this would indeed prevent an in depth analysis of BIT investment disciplines.

2. Foreign Law Debt

Let me now turn to the more complicated issue on how treaty claims stemming from the use of *iure imperii* powers could possibly arise in the context of debt contracts governed by foreign law. We have already seen that generally, the mere non-payment of one's debts is not an act *iure imperii*, just as the conclusion of the very debt contract is a commercial and not a sovereign act. Every private debtor can do the same. The difference between corporate and state insolvency is that states tend to adopt debt moratoria in the form of emergency laws to declare the cessation of pay-

66 *Sonnenberger*, in Münchener Kommentar zum EGBGB, 4th ed. 2006, intro. to EGBGB, paras. 123, 413.

67 Unfortunately, this question is far from settled. In English law the above assumption is correct, *Kahler v. Midland Bank*, [1950] A.C. 24, 56 per *Lord Radcliffe*. To the contrary, German courts have a strictly territorial approach, refusing to give effect to foreign public law norms even when that is the proper law of the contract, BGH NJW 1960, 1101, 1102. The traditional French doctrine of *contract international* adopts an approach similar to the German one and was applied in the classic Serbian Loans Cases before the PCIJ in 1929, but purely as a matter of French law, *Case Concerning the Payment of Various Serbian Loans Issued in France,* PCIJ Ser. A Nos. 20/21, 46-47. The ICJ case had ample opportunity to rule on the issue but refused to hear the case on the merits, ICJ, *Case of Certain Norwegian Loans*, ICJ Rep. 1957, 9, 27, diss. op. by Judge *Read*, 85.

68 On this general principle of international law see *Sir H. Lauterpacht*, *Case of Certain Norwegian Loans,* sep. op., supra note 67, 37.

ments on their external debts.[69] By intention, these laws have an extraterritorial reach. Prior to any examination on whether the emergency laws comply with substantive BIT obligations, an ICSID Tribunal has to assess whether it gives effect to a debt moratorium despite its extraterritorial reach. Although, as far as the author is aware, ICSID Tribunals have not had to deal with this issue, two alternative solutions can be identified. Arguably, the outcome of ICSID proceedings on the issue will depend on whether the arbiters have a public international law or private international law background.

The private international law approach: Arbiters regarding the question of extraterritorial application of public law norms primarily as a question of conflicts of laws would presumably rely on jurisprudence in the forum of the proper law, especially when there are judgments on the very same issue of state insolvency. Where a local court has already declined to give effect to the debtor state's emergency laws because of their extraterritorial reach (as is the case in U.S. 2nd Circuit law),[70] a "disintegrationist" Tribunal could defer to such a ruling and consequently refuse to analyze the specific BIT disciplines. This would be advantageous since, firstly, it would avoid diverging decisions between ICSID and domestic courts on the same case and, secondly, it would also mitigate the "abuse-threat" (i.e. judgment creditors taking to ICSID who have been unsuccessful in collecting on their domestic law judgments). Yet, the major disadvantage lies in the fact that domestic *fora* themselves are inconsistent on whether to recognize extraterritorially reaching emergency laws. A look at the recent Argentine insolvency highlights the dilemma of the private international law approach: The Italian *Corte di Cassazione* is diametrically opposed to 2nd Circuit jurisprudence as it expressly acknowledges that the emergency laws on the cessation of payments constitute non-justiceable *iure imperii* acts, thus implicitly giving them the sought extraterritorial effect without even elaborating on the extraterritoriality problem.[71] In an Italian Bondholder v. Argentina case before a "disintegrationist" Tribunal, Argentina would probably be estopped from raising a "*contract-claim-defence*" as it (successfully) invoked its sovereign powers in Italian courts in the very same case.[72] Thus, under a private international law approach, the inconsistencies of national jurisprudence could cause another line of inconsistent ICSID decisions. Ironically, at the end of the day, the Italian investor might be better off than his U.S. counterpart because ICSID awards can be better enforced than U.S. judgments.

The public international law approach: As an alternative solution, ICSID could engage in an autonomous assessment on whether a debt moratorium can, despite its extraterritorial reach, affect foreign law debt contracts. Although this approach has

69 See the Argentine Emergency Law No. 25. 561 dated 6 Jan. 2002 and the debt moratorium under this Emergency Law No. 256/2002, dated 6 Feb. 2002.

70 See supra II. 3.

71 Corte Suprema di Cassazione, supra note 26, 5.

72 In *SGS v. Pakistan (Jurisdiction)*, supra note 46, para. 139, an ICSID Tribunal held Pakistan to its pleadings in foreign (Swiss) courts that certain acts were non-justiceable *iure imperii* acts.

the advantage of allowing a coherent ICSID jurisprudence to develop, it would soon face the problem that practice-proof international law rules on the extraterritorial application of domestic law are very difficult to detect.[73] One possible yardstick would be the requirement of a *bona fide* connection between the subject matter and the respective state laws,[74] a test that would presumably be satisfied where a state enacts laws specifically designed to affect its own contracts. This is of course not to say that the emergency measures are BIT-legal, quite the contrary is true: The (applicable) measures would in a later step have to be tested against the BIT obligations of the state. The fundamental problem with an autonomous assessment is that the outcome will necessarily conflict with some national court judgment, which is most drastic when domestic courts and ICSID decide over the very same emergency measures (as could be the case with U.S. courts, Italian courts and ICSID deciding on the Argentine emergency measures). For the sake of coherent ICSID jurisprudence, the public international law approach would have to choose between either denying justice to Italian bondholders or (arguably) being abused by American creditors.[75]

The analysis shows that both possible approaches have material disadvantages, and there does not seem to be a way to escape this dilemma. Nonetheless, the issue would have to be solved in one way or the other by a "disintegrationist" Tribunal that only looks at cases where the state has made use of its *iure imperii* powers.

IV. Treatment Obligations under BITs

We now head back to the more known territory of Investment Law, the individual BIT treatment obligations. Whether or not a Tribunal actually reaches this stage will largely depend on its stance on the two prior issues. This study does not provide a full-fledged analysis on every individual investment discipline, given that much is still in flux and that some topics are also addressed separately at this conference. In

73 *Dolzer*, Extraterritoriale Anwendung von nationalem Recht aus der Sicht des Völkerrechts, Bitburger Gespräche, Jahrbuch 2003, 71, 79.

74 *Brownlie*, Principles of Public International Law, 6th ed. 2003, 309, with further references. The WTO Appellate Body employs a "sufficient nexus"-test, Report of the WTO Appellate Body Report, *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 Oct. 1998, para. 133.

75 The *deni de justice* claim from Italian bondholders would sound like this: While Italian Courts are not hearing our case because the measures complained of are considered non-justiceable *iure imperii* acts, the "disintegrationist" ICSID Tribunal considers them ineffective and thus refuses to hear our pure *iure gestionis* contract claims. The abuse claim against U.S. creditors would be that U.S. creditors already had the emergency laws declared ineffective in U.S. courts. Bringing the claim to ICSID alleging that Argentina made use of its *iure imperii* powers to tamper with their contractual rights seems abusive since investors would be allowed to exploit enforcement possibilities not enjoyed in domestic lawsuits.

addition, any *ex ante* analysis must remain vague since every Tribunal will have to decide on the case specific measures.

As a preliminary point, it should be noted that while ICSID Tribunals will not judge on the monetary policy of the insolvent state (such as an abandonment of a currency peg), they will not be willing to accept a "general measures of economic policy" objection in order to sustain debt moratoria: Tribunals have "jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor …"[76]

One overriding question that will determine any analysis of specific treatment obligations will be whether account shall be taken of the circumstances under which a state adopted the challenged measures, as constantly raised by Argentine in the current ICSID proceedings.[77] In the alternative, the Tribunal would disregard the state's motivation and merely assess the effects of the emergency measures on investments, regarding the circumstances only on the "defences" stage.

1. Expropriation

The "circumstances-question" is currently debated in the context of expropriation and has given rise to diverging ICSID decisions.[78] An outright repudiation of sovereign debt would certainly be a clear case of direct expropriation which, in the absence of prompt, effective and adequate compensation, is a BIT violation.[79] The more intricate question is whether emergency measures could constitute a creeping or indirect expropriation The NAFTA-*Metalclad* decision suggested that a deprivation of reasonable to be expected economic benefit constitutes an indirect expropriation.[80] Presumably, the Tribunal, both in and outside the state insolvency context, would require a certain degree of interference with this reasonable-to-be-expected benefit.[81] A legislative fiat that stretches the maturity date of certain debt instrument to a limited extent could be acceptable while changing maturity for a significant

76 *CMS v. Argentina (Decision on Objections to Jurisdiction)*, Case No. ARB/01/8, 42 I.L.M. 799 (2003), para. 33 (emphasis added).

77 *CMS v. Argentina (Application for Annulment)*, 8 Sept. 2005, paras. 19-23, http://ita.law.uvic.ca/documents/cmsannulmentapplication.pdf.

78 *Kunoy*, Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration, 6 J. World Investment & Trade, 467, 469-472 (2005).

79 *Wälde*, supra note 2, 409. Argentine bondholders state that the recent Argentine law adopted in the aftermath of the June-2005 restructuring actually constitutes such repudiation, see *White & Case*, Recent Argentine Legislation and Bondholder Remedies, Memorandum to the Global Committee of Argentine Bondholders, 3. http://www.gcab.org/images/GCAB_ICSID_Postion_Paper_2-15-05.pdf.

80 *Metalclad v. Mexico(Award)*, Case No. ARB(AF)/97/1, 40 I.L.M. 35 (2001), para. 103.

81 There are diverging decisions on whether the degree of interference matters, *Kunoy*, supra note 78, 485-487.

time (i.e. from 5 to 30 years) could be viewed differently. It is to be noted that the CMS decision of May 2005 is of little avail in our context as it has to be seen in the specific minority-shareholder setting.[82]

2. Fair and Equitable Treatment

Although the discussion on what fair and equitable treatment means is still controversial, recent ICSID jurisprudence strongly relies on the legitimate expectations of the investor at the time of the investment decision.[83] In *CMS*, the Tribunal held that the conversion of dollar based claims to a local currency "*entirely transform[ed] and alter[ed]*" the business environment of the investment and thus violated the fair and equitable treatment standard.[84] A Tribunal would thus have to determine which investor expectations are actually so material to be covered by this "*entirely alter and transform the legal and business environment*-test". This could be tricky an exercise because on international securities markets, the legal features of debt instruments minutiously affect the price investors are willing to pay. One could make the argument that all characteristics of a debt security have an influence on the investment decision and are therefore material. A more narrow interpretation could regard as material only some key financial terms of a debt instrument, such as currency, maturity or, as the case may be, collateral features.[85]

3. Transfer Rights

Other treatment obligations of interest are provisions whereby states grant investors the right to freely transfer any received payment into a freely convertible, stable currency.[86] These guarantees, which trump the states' rights to adopt capital export control laws under Art. VI (3) of the IMF Agreement,[87] could be raised in a case like the Russian restructuring where ruble-payments were made into blocked accounts

82 *Schill*, From Calvo to CMS: Burying an International Law Legacy, SchiedsVZ 2005, 285, 289-290.

83 *Dolzer*, Fair and Equitable Treatment: A Key Standard in Investment Terms, 39 Int'l L. 87 (2005).

84 *CMS v. Argentina (Award)*, supra note 60, para. 275.

85 *I.e.* when a state undertakes to use certain revenues exclusively for debt servicing purposes and later removes this collateral feature by unilateral legislative action.

86 *Inter alia* see U.S. Model BIT Nov. 2004, supra note 43, Art. 7.

87 *Reinisch*, State Responsibility for Debts, 1995, 101. In *Hood Corp. v. The Islamic Republic of Iran et. al.*, the Iran-U.S. Claims Tribunal had the chance to rule on the relationship between the IMF Articles of Agreement, 22 July 1944, 2 U.N.T.S. 124, as amended through 28 June 1990, and the Iran-U.S. Treaty of Amity which contained a transfer guarantee similar to the BIT provisions. The Tribunal held the Treaty of Amity inapplicable on other grounds, see *Aldrich,* The Jurisprudence of the Iran-United States Claims Tribunal, 1996, 393.

that did not allow the investors to withdraw the funds and exchange them into dollars.

4. Umbrella Clauses

Even if umbrella clauses are not interpreted to elevate every contractual claim to a treaty claim,[88] they can still have a significant impact on a state's ability to adopt measures in situations of financial distress. In fact, a respective BIT clause could be interpreted to prohibit a state to adopt any *iure imperi* measures that would affect debt contracts held by foreigners. Umbrella clauses could thereby have the effect of a stabilization clause, a curious result as debt contracts hardly ever contain stabilization clauses.[89] Such an interpretation would render false the long standing perception that with respect to domestic law debt, the debtor state is free to change the law to adapt it to its public policy needs. It would be interesting to see markets reaction if an ICSID Tribunal in fact gives umbrella clauses so broad a meaning, because generally, the debtor state's (perceived) law making powers make domestic law debt much more risky, yielding much higher risk returns.[90] A more narrow interpretation would subject the umbrella clause to a public policy exemption to the benefit of the debtor state.

5. Non Discrimination, National Treatment and MFN

Last but certainly not least, the treatment obligations of national treatment, MFN and non-discrimination could play a major role in state insolvency cases under BITs. Inter-creditor equity has always been the fundamental concern for creditors.[91] At the outset it has to be noted that these provisions can become relevant for both "intergrationist" and "disintegrationist" Tribunals.

Generally speaking, the major task for Tribunals would be to assess whether or not an alleged unequal treatment occurred among similarly situated investors, a concept known to investment law[92] and state insolvency "law"[93] as well. This would

88 See supra III. 2.

89 *Siebel*, supra note 14, 190.

90 Argentina recently called off a domestic law bond launch because investors demanded too high a risk premium, see *Bloomberg News*, Argentina Cancels Bond Sale, Won't Pay 8.8% Yield, 21 Sept. 2005, http://www.bloomberg.com/apps/news?pid=email_us&refer=news_index&sid=ak3QHaN1eXLk.

91 Historically, discrimination based on the nationality of creditors has been a cause for diplomatic intervention by the investors' home governments, *Borchard*, supra note 9, 260-266.

92 *CMS v. Argentina (Award),* supra note 60, para. 293. *Wälde*, supra note 2, 411-414, stressing the parallel to the "like-products" problems in WTO law.

93 *Clark*, supra note 50.

surely require the state to treat holders of identical debt instruments identically. A highly political issue in this regard is whether a state is entitled to grant domestic creditors, such as domestic banks, better restructuring terms (or even entirely save them restructuring) compared to foreign creditors holding the same debt instruments. While *de jure* this looks like a clear-cut violation of national treatment commitments,[94] at least an economic case can be made for treating local creditors on a preferential basis.[95] Besides the national treatment question, BIT-MFN-obligations outlaw playing favourites among foreign creditors for political reasons. Where creditors are not holding identical debt instruments, the Tribunal would have to develop its own criteria to assess which groups of creditors are similarly situated and thus have to receive equal treatment. While developing these criteria could sometimes be burdensome (such as the question of whether or not a state is justified in paying multilateral institutions ahead of private foreign lenders),[96] at least some situations seem straightforward. *Inter alia,* trade creditors and bondholders are not similarly situated, a fact acknowledged by major creditor organizations.[97] Through a sophisticated classification of creditors, ICSID could help the state regain a stable current account and maintain basic services provided by foreigners (by allowing the state to pay *inter alia* foreign providers of airport security services).

Again, much of the outcome will depend on whether the circumstances of the crisis and public policy considerations will be considered for an examination of the treatment obligation assessment or only for possible defences.

V. Sovereign Defences

1. Acceptance of Majority Restructurings

As it is most likely that potential ICSID claimants would be holdout creditors (who are not participating in a voluntary debt swap), it is worth examining whether a sovereign could raise a defence that ICSID should not interfere with majority restructurings, i.e. where a (qualified) majority of creditors has accepted a restructuring plan. Such an objection, which would presumably be more prominent with "in-

94 In the Russian restructuring in 1998, local banks received significant secret side payments not made to foreign creditors, see *Sturzenegger*, Default Episodes in the 90s: Factbook, Toolkit and Preliminary Lessons, June 2003, 23, http://www.utdt.edu/~fsturzen/pinto2.pdf.

95 *Roubini*, Why Should Foreign Creditors of Argentina Take a Greater Hit/Haircut than the Domestic Ones?, 14 Dec. 2001 (First Draft), 4, http://pages.stern.nyu.edu/~nroubini/papers/discriminationforeigndebt.doc.

96 See *Martha*, Preferred Creditor Status under International Law: The case of the International Monetary Fund, 39 ICLQ 801-826 (1990).

97 *Institute for International Finance*, Principles for Stable Capital Flows and Fair Debt Restructurings in Emerging Markets, 31 March 2005, 14, www.iif.com/data/public/principles_final_0305.pdf.

tegrationist Tribunals", was envisaged by financial experts during the negotiations for the MAI.[98] But while there is no question that ICSID should give effect to a majority restructuring under CACs,[99] it is doubtable whether ICSID Tribunals can do the same in the absence of CACs, i.e. where the holdouts hold on to their old, unchanged debt claims. Annex G of the 2004 U.S.-Uruguay BIT actually has this effect, barring investor claims where creditors representing 75% of outstanding debt have accepted a restructuring offer, regardless of whether the original debt instruments allow for a majority restructuring or not.[100] The same approach was envisaged by the SDRM.[101] This might be a desirable result to enable more orderly debt restructurings and prevent a "rush to ICSID". However, there is no legal foundation for ICSID to uphold such a defence absent a clear treaty provision to that effect. The U.S.-Uruguay BIT and the IMF's SDRM proposal can certainly not be seen as evidence of a new customary international law rule that can limit BIT obligations.

2. State of Necessity and Debt Sustainability

A question common to those familiar with the current Argentina proceedings is whether a state in a situation of financial distress can invoke a State of Necessity, based on both BIT- and customary international law, to excuse BIT violations.[102]

A preliminary objection to such a defence was that BITs are intended to bite in times of economic difficulty and that the BITs' object and purpose exclude a State of Necessity defence (*Notstandsfestigkeit)*. The CMS Tribunal seems to embrace such an objection, stating that only in a situation of total collapse could a State of Necessity defence be raised The Argentine crisis, although being severe, would not qualify as a situation of total collapse.[103] Nonetheless, the Tribunal engaged in a (sometimes poorly argued)[104] substantive discussion of both Art. 25 of the 2001 I.L.C. Draft on State Responsibility[105] and the emergency clause Art. XI of the U.S.-Argentina BIT. I will briefly reproduce this discussion, highlighting some state insolvency specific questions that have not yet arisen in the pending proceedings.

The first prong a Tribunal has to assess when faced with a creditor claim against an insolvent state is whether a state is facing a *grave and imminent peril for an es-*

98 *OECD*, supra note 58, 23.
99 See supra II. 2. After a CAC restructuring, a creditor is only entitled to receive the restructured amounts. These restructurings thereby automatically affect claims under umbrella clauses.
100 Supra note 39, 54.
101 *IMF*, supra note 3, 26.
102 As to other possible public international law defences see *Leyendecker*, Auslandsverschuldung und Völkerrecht, 1988, 150-240.
103 *CMS v. Argentina (Award)*, supra note 60, para. 354-356.
104 *Schill*, supra note 82, 291.
105 As adopted by the U.N. General Assembly Resolution 56/83, 12 Dec. 2001, Official Records of the General Assembly, 56th Sess., Suppl. No. 10 (A/56/10).

sential interest when paying the claimant. Any definitive answer to this question would presumably require an assessment of the country's debt sustainability, the notion developed by the IMF that (in the IMF's view) justifies a sovereign debt restructuring.[106] The major problem here lies in the fact that states, invoking their fiscal and monetary sovereignty, fiercely oppose a legally binding determination of their debt sustainability by an international body. Consequently, the SDRM would have lacked the power to assess the debt sustainability of a country.[107] By contrast, in international law, as applied by the CMS-Tribunal, Necessity is not a self-judging concept.[108] Accordingly, an ICSID Tribunal has to make its own assessment of the Necessity/debt sustainability situation in a two step analysis: What are the foreign exchange reserves of the state? And what exactly are the recognizable essential interests (the *beneficium competentiae*) of a state that are protected by the State of Necessity notion? Arguably, ICSID Tribunals lack the resources to engage in such an analysis, so using more capable authority would be appropriate. Unfortunately, at least in the Argentina case, the IMF constantly refused to state whether, in its opinion, Argentina is unable or only unwilling to pay.[109] A related problem would be how to treat a creditor that only sues for a small amount, the payment of which cannot be said to cause a grave and imminent peril.[110]

Another crucial element of the State of Necessity test is whether the contested measure is *the only way* for the state to remedy the situation of necessity, Art. 25 (1) (a) I.L.C. Draft. The CMS-Tribunal is very (too?) restrictive on that point, leaving the state practically no discretion on how to react in an emergency situation.[111] It goes without saying that every individual state insolvency situation would warrant a case-specific analysis.

Lastly, the delicate question of contribution (a state cannot invoke Necessity where it has itself contributed to the situation of Necessity, Art. 25 (2) (b) I.L.C. Draft) could eliminate any State of Necessity defence in the state insolvency context. Of course the state has contributed to its debt burden when it voluntarily tapped capital markets. The CMS-Tribunal indicates that this could in fact be the end of the story, basically restricting the State of Necessity to cases of purely external in-

106 *IMF*, supra note 3, 22.

107 *IMF*, supra note 3, 28. In general see *Gianviti*, The Prevention and Resolution of International Financial Crisis: A Perspective from the International Monetary Fund, in *Giovanoli* (ed.), International Monetary Law – Issues for the New Millennium, 2000, 97, 108.

108 *CMS v. Argentina (Award),* supra note 60, paras. 373-374. ICJ, *Case Concerning the Gabcíkovo-Nagymaros Project*, ICJ Rep. 1997, 7, 40 with references to the work of the I.L.C.

109 *Gelpern*, After Argentina, Policy Briefs in International Economics, IIE Paper No. PB05-2, Sept. 2005, 5, http://www.iie.com/publications/pb/pb05-2.pdf.

110 See *Pfeiffer*, Zahlungskrisen ausländischer Staaten im deutschen und internationalen Rechtsverkehr, 102 ZVglRWiss 141, 163-164 (2003), promoting an examination of the overall debt situation (Gesamtbetrachtung).

111 *CMS v. Argentina (Award),* supra note 60, paras. 323-324. As to the criticism see *Schill*, supra note 82, 291; *CMS v. Argentina (Annulment Application),* supra note 77, paras. 81-82.

fluences.[112] Whether or not this restrictive interpretation will stand remains for the Annulment Committee to decide.[113]

D. Procedural Questions

After this analysis of the substantive treaty obligations, let me now turn to two procedural aspects that will be relevant in proceedings against an insolvent sovereign.

I. Stay of Proceedings During Restructuring Negotiations

In the discussions on the SDRM, the IMF insisted on a stay of court (enforcement) proceedings during ongoing restructuring negotiations in order to prevent obstructive creditor behaviour.[114] While U.S. courts have occasionally granted temporary stays,[115] Tribunals do not have the authority to stay proceedings until the end of restructuring negotiations, once the waiting period usually stipulated in BITs has lapsed.[116] Under current ICSID Rules, stays from enforcement are only permissible pending Interpretation, Revision and Annulment Proceedings, Art. 50-52 ICSID Convention.[117] To allow for a stay of proceedings pending restructuring negotiations, the Administrative Council would have to amend the Arbitration Rules under Art. 6 (1) (c) of the Convention.

II. Enforcing Creditor Claims and Diplomatic Protection

We have already come across the possibility of enforcement of ICSID awards on some occasions. Enforcement issues have so far rarely arisen because states gene-

112 *CMS v. Argentine (Award),* supra note 60, para. 329. *Schill*, supra note 82, 291. This deprives Art. 25 of any relevance. Cases "beyond the control of the state" are governed by Art. 23 (*Force Majeure*) I.L.C. Draft.

113 *See CMS v. Argentina (Annulment Application)*, supra note 77, paras. 83-84.

114 *IMF*, supra note 3, 25 (subjecting a stay to the approval of a 75% creditor majority).

115 *Pravin Banker Assocs. v. Banco Popular del Peru and the Republic of Peru*, 1994 U.S. Dist. LEXIS 2003, 23-33 (S.D.N.Y. 24 Feb. 1994). *Lightwater Corp. v. Argentina*, 2003 U.S. Dist. LEXIS 16868 (S.D.N.Y. 29 Aug. 2003, stay of execution). *Allied Bank International et. al. v. Banco Credito Agricola de Cartago et. al.* 733 F2d 23, 27 (2nd Cir. 1984). *Skeel*, Why Contracts are Saving Sovereign Bankruptcy, Int'l Fin. L. Rev. March 2006, 23, sums up the efforts as "mixed results".

116 Even these requirements could be rendered obsolete by virtue of MFN Clauses, see *Siemens v. Argentina (Decision on Jurisdiction)*, Case No. ARB/02/8, 44 I.L.M. 137 (Jan. 2005), paras. 79-109.

117 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, 575 U.N.T.S. 159 (hereinafter the Convention).

rally pay their ICSID awards.[118] However, the Argentine case suggests that this perception is invalid in state insolvency cases,[119] even though states clearly are under an international law obligation to comply with ICSID awards, Art. 53 (1) ICSID Convention. Hence, execution becomes a material concern for creditors, debtors and the entire ICSID system alike.

Enforcement is governed by Art. 54, 55 ICSID-Convention. Any contracting state is under an obligation to enforce an ICSID award as if it were a final judgment in that state, Art. 54 (1). The enforcement procedure is subject to the laws concerning execution of judgments in the state where enforcement is sought, without prejudice to local laws on immunity from enforcement, Art. 54 (3), 55. By virtue of this latter limitation, the traditional obstacles to execution outside of the debtor state's territory will also play out in the ICSID context. The restrictive immunity from enforcement theory (as predominantly applied among ICSID member states), as well as international law on diplomatic immunities, will prevent creditors from attaching assets of the diplomatic mission and other assets used for *iure imperii* purposes.[120] Although this causes inconveniences for the debtor state by impeding its commercial activities abroad, commercial assets will in most cases not be available for the creditor outside the debtor's territory.

One (perceived) advantage of Investment Treaty Arbitration from an investor's point of view is that, compared to domestic court judgments, ICSID awards can be enforced easier in the debtor state itself, at least in theory.[121] ICSID awards have the status of a final judgment of the debtor state's courts and must not be subjected to a public policy review by local enforcement authorities, clearly constituting an improvement compared to the enforcement of foreign court judgments and arbitral awards.[122]. A local court is by international law obliged to enforce an ICSID award without testing it against local emergency laws. Although the reference to local enforcement laws in Art. 54 (3) cannot introduce a public policy review through the backdoor,[123] it mitigates the advantages of ICSID proceedings. The debtor state is

118 *Schwarcz,* Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach, 85 Cornell L. Rev. 959, 1028 (2000).

119 *Alfaro/Lorenti*, The Growing Opposition if Argentina to ICSID Arbitral Tribunals, 6 J. World Investment & Trade, 417-430.

120 See supra II. 3. As to the immunity from attachment of diplomatic assets, see Vienna Convention on Diplomatic Relations, 18 April 1961, 550 U.N.T.S. 95, Art. 22 (3).

121 *Griffin/Farren*, How ICSID can protect sovereign bondholders, Int'l Fin. L. Rev. Sept. 2005, 21, 23.

122 See The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958, 330 U.N.T.S. 38, Art. V. For *exquatur* proceedings, see *Baars/Böckel*, supra note 33, 463.

123 *Schreuer*, The ICSID Convention – A Commentary, 2001, Art. 54 para. 104. Argentine attempts to that effect, see *Alfaro/Lorenti*, Argentina: The Enforcement Process of the ICSID Awards, Mondaq Business Briefing, 1 June 2005, www.mondaq.com, gravely err on that point of law.

free to invoke its own laws on immunity from enforcement to evade execution, and these local enforcement laws themselves are not subject to ICSID review.[124]

A more real enforcement prospect brings us to the more traditional sphere of international law, that of diplomatic protection. Failure of the debtor state to comply with an award (or a local judge striking down an award on local public policy grounds) triggers the state's international responsibility and can give rise to diplomatic protection of the creditors' home states, Art. 27 Convention, including taking the case to the ICJ, see also Art. 64 Convention.[125] Even more effective sanctions to compel the debtor state to pay could be exerted by ICSID's parent institution, the World Bank, as well as the latter's Bretton Woods twin, the IMF. U.S. lawyers have already pointed at the Helms Amendment under which the U.S. government is by law prohibited from making financial contributions to a country that repudiates or nullifies contracts with a U.S. person. This prohibition, which would presumably cover a default on ICSID awards, includes contributions through the IMF and the World Bank.[126] Given U.S. voting power in the Bretton Woods institutions, the Helms Amendment could be a very powerful tool in the creditors' hands.

Tribunals should have these political and diplomatic consequences in mind when deciding on the substantive issues outlined above, especially when creditors already have obtained judgments in local courts and have recourse to ICSID merely for the better enforcement prospects.

E. Conclusion

I. How Could State Insolvency Change Investment Treaty Arbitration?

In our analysis, we have seen some key challenges ICSID Tribunals will face when confronted with the phenomenon of state insolvency. The first challenge, both in procedural and substantive terms, is that the potential number of claimants (who are

124 *Schreuer*, supra note 123, Art. 55 para. 99, emphasizes that ICSID drafters contemplated withdrawing immunity under the laws of the host state but abandoned that idea. Many states have immunized their domestic assets from enforcement, *Wood*, Project Finance, Subordinated Debt and State Loans, 1995, 154.

125 A case before the ICJ under Art. 64 ICSID seems straightforward where the state does not pay the award. The debtor state could claim that it is simply unable to honour its obligation under Art. 53 (1) ICSID because it lacks sufficient funds, see *Lowe,* Some Comments on Procedural Weaknesses in International Law, 98 Am. Soc'y Int'l L. Proc. 37, 39 (2004) on Argentina's situation. The ICJ might engage in an analysis under Art. 61, 62 Vienna Convention on the Law of Treaties, thus further fragmenting international law.

126 22 U.S.C.S. § 2370a. See *Maiden,* Argentina Ruling Calls Halt to Holdout Litigation, Int'l Fin. L. Rev. June 2005, 6, 7. The Helms Amendment was already employed by an American investor to stop payments by the Inter-American-Development Bank to Costa Rica as long as Costa Rica did not accept ICSID Arbitration, *Compañía del Desarrollo de Santa Elena S.A. v. Costa Rica (Final Award)*, Case No. ARB/96/1, 15 ICSID Rev. – F.I.L.J. 169, paras. 24 ff. (2000).

everything but a homogenous group) largely exceeds that known from prior ICSID proceedings. Moreover, state insolvency raises some known substantive investment treaty questions in a new context, such as the State of Necessity/debt sustainability problem. Other issues such as the extraterritoriality issue are entirely new and reflect the structural differences between classic FDI and sovereign debt.

Undoubtedly, the sticking point to predict the outcome and the very nature of state insolvency proceedings in Investment Treaty Arbitration lies in the distinction between contract claims and treaty claims. Tribunal consistency on this issue is of fundamental importance for states and creditors. If the integrationist view prevails, and every sovereign default constitutes a BIT violation, ICSID could become very prominent a forum for an insolvent sovereign's creditors.

II. How Could ICISD Change the "Law" of State Insolvency

How then does Investment Treaty Arbitration have the potential to change the "law" of state insolvency? One instance where BITs and ICSID can have a significant impact is domestic law debt. If the monetary and exchange control laws of the debtor state are tested against the state's BIT obligations, investors' risk awareness towards domestic law debt could wane, especially if umbrella clauses are given the effect of stabilization clauses (see supra III. 4. d.). More importantly, Investment Treaty Arbitration, if enforced through the Helms Amendment, could significantly change multilateral emergency lending. If ICSID Tribunals rule in favour of holdout creditors, and if the Helms Amendment applies, the IMF and the World Bank would be barred from issuing emergency packages beyond its current policies that allow for lending into arrears under certain circumstances.[127] This could mean a significant shift in bargaining power during sovereign debt restructuring negotiations.

The future of sovereign debt workouts seems to lie in CACs that can mitigate the collective action problems. Investment Treaty Arbitration is not likely to tamper with CAC restructurings.[128]

127 *Salmon*, Sovereign Finally Closes Debt Restructuring, Euromoney July 2005, 42, 43. For the IMF, see *IMF*, Fund Policy on Lending into Arrears – Further Considerations on the Good Faith Criterion, 30 July 2002, 5.

128 We have so far overlooked majority enforcement clauses often used in trust indentures under U.K. law and becoming more prominent in New York law debt. Under these clauses, the initiation of lawsuits in domestic courts requires approval by 25% of the represented outstanding principal, see *Drage/Hovaguimian,* supra note 18, 5. How, under these circumstances, an "integrationist" Tribunal will react if a minority bondholder sues individually invoking an umbrella clause would be interesting to observe.

III. Would ICSID Make a Good SDRM?

In light of the preceding analysis, how can Investment Treaty Arbitration under ICSID (a World Bank institution after all) be reconciled with the ambitious IMF proposal for an SDRM? Could ICSID perform functions of such a body where support for an institutionalized SDRM is lacking? Or would ICSID Arbitration actually run counter to the general SDRM principles identified by the IMF? It is obvious that Investment Treaty Arbitration cannot function as a full-fledged SDRM The IMF heavily borrowed from national insolvency proceedings when designing its SDRM. ICSID Tribunals are not – without amendment of the Convention – intended to perform administrative functions of a national insolvency court. ICSID Tribunals are certainly not a forum where a distressed sovereign could file for bankruptcy (i.e. initiate a debt restructuring). As outlined above, ICSID would not even have the procedural competence to suspend holdout proceedings to await restructuring negotiations (supra IV. 1.), let alone certify a restructuring plan like a national insolvency judge would.

However, the IMF proposal also introduced a Dispute Resolution Forum (DRF) for creditor/debtor disputes that in fact relied on ICSID as a role model, though primarily for procedural matters.[129] Whether or not ICSID could perform functions of the (rejected) DRF will heavily depend on ICSID's self perception, especially with regard to the contract /treaty claims distinction. The DRF was designed as a "contract" forum that could *inter alia* rule on the validity of individual creditor claims. "Integrationist" Tribunals will face many of the substantive issues discussed in the SDRM context. The above analysis has shown that ICSID Arbitration and the SDRM principles are not always congruent. This firstly goes for the scope of ICSID Arbitration, which would include domestic law debt but would exclude nationals of the debtor state, contrary to the proposed DRF.[130] More significantly, under ICSID, a majority restructuring would not bind holdout creditors, a key feature of the SDRM. The same goes for a stay on creditor enforcement actions. Lastly, if the CMS decision stands, ICSID would have to make an autonomous assessment of the state's debt sustainability, which the DRF was expressly prohibited from doing.[131] A thorough interpretation of the BIT principles of national treatment, MFN and non

129 *IMF*, The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations, 27 Nov. 2002, 63, 69, http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf. See *Schwarcz*, supra note 118, 1024-1030.

130 *IMF*, supra note 3, 23.

131 *Id.*, 28

discrimination could, however, contribute to enhanced inter-creditor equity (supra III. 4. e.).

State Insolvency – Consequences and Obligations under Investment Treaties

Comment by *Peter Gnam*[*]

A.

From time to time there are situations also on the economic as well as political platform where "it takes two to tango". Facing insolvency and making efforts to get along with it could very well be such a "tango situation". The debtor makes short and long strides in all directions, but not getting away that much from those eager to dance with him, cheek to cheek, so as to get as much feeling as possible for the debtor´s movements and for what is left of the body to represent an asset which is worth dancing for it. Well, tango is popular in a way, but not everybody likes to dance it, in particular if the dancing part of the debtor is acted by a state, and if there are too many creditors bound to dance this kind of tango on a too small dancing floor.

B.

Mr. *Szodruch* has already thoroughly dealt with issues arising from portfolio investment under a sovereign debt default scenario. So I would like to focus my comments on the more traditional Foreign Direct Investment and its potential risk exposure in case of a state insolvency.

Bilateral Investment Treaties (BIT) are designed to support national companies (or even individuals) of one state who want to invest in the other contracting state by safeguarding as much as possible a predictable and reliable legal framework for such investment; this way an investor should be encouraged but also promoted to make direct investments into countries which are in need of them but lack the financial and/or technical capabilities to do it on their own. The purpose of any such Treaty is expressed in its respective Title and Preamble and is "to protect" and "to promote" investments.

BITs are not specifically designed to protect and promote sovereign bondholders, be it individuals or classes of them. We have learned from the paper presented by Mr. *Szodruch* whether and under which criteria they can qualify for being treated as "investors", and that it needs a little bit of doing to get the sovereign bondholders

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into and under the protection scheme of a BIT and onto the Investment Treaty Arbitration road.

As opposed to Foreign Investors, sovereign bondholders - under the respective terms and conditions for the emission of the bonds - a priori have a direct financial claim on repayment of the bond and interest; when they want to make use of a BIT and its possible arbitration clause, they do it to get an enforceable award on such repayment and thus to improve their chances for its execution. A Foreign Investor does not necessarily have financial claims against a state from the outset; but he has a claim that the state complies with all and any non-financial and legal commitments it has undertaken so as to make the investment feasible and its implementation safeguarded. Only in case the state does not meet any such commitment, the BIT appears on the scene so as to verify whether there is a breach of the BIT, and whether this breach has lead to a damage to the investor which then may or may not constitute a claim for money (compensation of damages) against the state in default under the BIT. However, such claim, when raised under a BIT, does not per se qualify to be added to the "debt pool" of a state insolvency and to give the claiming investor the position of a creditor in such insolvency. There is still a long way to go, if the state does not acknowledge such claim from the outset, which he normally does not.

Before we have a look into the practice of Foreign Direct Investment, a last observation in this context: it appears that the purpose of a BIT as outlined before and the purpose of whatever structure or procedure used for solving a state insolvency, do not match; they even seem to be contra-rotating. As there cannot be a liquidation of the state and its public assets, all concepts for solving a state insolvency are in the end directed to protect the state against its creditors (as opposed to the protection of an investor under a BIT); the creditors – so as to have a workable balance towards the needs of the state and the welfare of its citizens – are required to contribute to a solution of the "crisis" by e.g. writing off substantial parts of their financial claims. As for the foreign investors, the "encourage and protect investment–doctrine" of a BIT is turned upside down, and there is not much legal aid left to avoid the partial or total sacrifice of the investment.

Foreign Direct Investment mainly comprises large scale projects. In most cases, the investment is invited by a state to build up or strengthen its public service sector in the fields of energy or water supply network, oil and gas production, transport systems, telecommunication and IT infrastructure, but also to provide medical centers, hotel and resort complexes and the like. The investment required for such projects is mostly of substantial magnitude – and the state doesn´t have the money to spend on it, although being very often badly in need of accomplishing such projects.

In the last 2 or 3 decades, there very seldom have been, if at all, investment projects for which the state had to directly pay money to an investor. Foreign Direct Investment does in principle not create a creditor–debtor relation between the investor and the state per se or require it – at least as far as debt of money is concerned. These projects are either financed in the classic way through institutional or private lending – the state hereby becoming a financial debtor to the lenders, not to the investor – or through one of the tools of private project financing ranging from sup-

plier´s credit to BOT models or business outsourcing; in the latter cases, the investor assumes the advance obligation to have the project (or his participation in a privatized company) financed by his own resources or financing instruments, and he gets his "Return of and on Investment" from his participation in whole or in part in the proceeds of the project as a going concern.

Under a Foreign Direct Investment scenario, the role of the state is therefore not based on assuming payment obligations but is to establish and uphold stable, reliable and predictable investment conditions for the investment it is calling in, particularly in the administrative and legal environment. So the obligation of the state towards an investor is more an immaterial one, without a genuine financial debt exposure. The state by granting (non financial) guarantees, authorizations or licenses, or by creating specific administrative or legal infrastructures, safeguards an environment in which the project as a going concern shall be protected and can so pay back the investment by itself – and by e.g. paying taxes can even positively contribute to the state´s liquid assets.

One certainly can say that a state insolvency situation as such does not affect any such non financial commitments undertaken by the state. So it should not come as a surprise when I tell you, that the factor insolvency of a state – as a potential or given situation – is not and, as far as I know, never has been a relevant factor in any risk assessment an investor makes, before engaging in a cross border investment; honestly spoken: the management in charge of any such project und its legal advisors don´t even think about it.

It is the BIT which an investor becomes aware of and wants to call in, if and when there is a non fulfillment of a state´s commitments towards an investment or otherwise a violation of Treaty standards. And it is a default of the state in this respect which can substantially change the investor´s role towards the state: the investor, having so long been a "beneficiary" of the state under the investment protection scheme, mutates into a "creditor" of the same state, provided he suffers a damage and has the ius standi to present a financial claim under the Investment Treaty Arbitration scheme; and in case, after 3 to 5 years of arbitration proceeding, there is an enforceable award, favorable to the investor, the foreign investor from this moment on, and not earlier, can join the bandwagon of all the other financial creditors to the state and enjoy facing the realities of the actual debt situation of the state, an insolvency being imminent, already pending or not.

From a practical point of view, for the investor there is not much timing or even strategy available when and how to structure an Investment Treaty Arbitration along a state insolvency. Apart from the fact that one can not predict whether the insolvency of a state is of long term or rather short term nature, whether it occurs at the beginning of an arbitration proceeding, in the middle of it or thereafter, there is not much control on orientating the enforceability of an award to a certain stage of a state´s financial indebtedness. On the other hand, the investor needs an enforceable award anyway and this as soon as possible, so as to rank properly among other financial creditors, if need be.

In this context, I do not see much value in a discussion whether to establish rules on a "stay" for Investment Treaty Arbitration proceedings as long as an insolvency of the defendant state is pending or in a critical stage. An investor is somewhat lost in an insolvency as long as his claim is neither acknowledged by the state nor yet awarded by a tribunal and enforceable. The mere fact that there might still come up the one or other potential enforceable claim against a state in the distant future cannot have any impact on the need to solve an existing insolvency situation in the interest of the state itself and the well-being of its nationals but also in the interest of the financial creditors. A different aspect could be the question of having an "automatic stay" of enforcement of awards once there actually is a state insolvency. But this is neither a question under a BIT nor under the ICSID Rules, as an automatic stay had to apply to all creditors and would therefore require a statutory regulation under the insolvency procedure itself.

Argentina´s insolvency is over, for the time being; it was a fairly short one, if it has been one at all. One should not forget, however, that there still is an avalanche of 30 or more Investment Treaty claims pending at ICSID against this state with a claim exposure probably exceeding 20 billions of USD. I leave it open whether this can lead to another dangerous indebtedness potential of this state, in case all these claims succeed and become enforceable awards. I leave it open because Argentina is going to develop a strategy to bar such claims from becoming a real threat to the state. Argentina intends to run all ICSID awards, when rendered against it, through the annulment procedure. A "catch all" annulment scenario as defense against a new indebtedness potential - that is something new, apart from having the effect of blocking ICSID arbitration to some extent. But what is worse, from a legal point of view, is the strong political and legal opposition to ICSID arbitration as such (invoking inter alia the *Calvo* doctrine again) and the motion of certain members of the Government, to prevent enforcement of ICSID awards; it is alleged that both the BITs and the system of ICSID arbitration itself could violate the Argentine constitution and that therefore any award rendered thereunder could be declared null and void by a domestic court. Should the Government really dare to invoke such nullity in the future, it would block investors, for many years to come, to have a valid and enforceable financial claim and become a "creditor" to the state. This might also give the politicians of BIT states some headache as it can have consequences on future BIT negotiations or prolongations and the value of Investment Treaty Arbitration.

C.

So much for the reality of consequences and obligations under Investment Treaties in practice. The problem for a foreign investor is not the insolvency as such; the problem seems to be rather the bumpy road an investor has to go to acquire the legal qualification to present his financial claim in a state insolvency, whenever this might happen. Just to close the circle: the foreign investor has a bad dancing card and the

state is a lousy dancer when it is about to take the dancing floor to dance the “tango bancarotta”.

State Insolvency – Consequences and Obligations under Investment Treaties

Comment by *August Reinisch*[*]

After the fascination and comprehensive *tour de horizon* on State insolvency issues and ICSID we have just heard by Mr. *Szodruch* I would like to focus on one particular aspect and that is the question whether ICSID, this highly attractive forum for a particular type of international economic disputes, i.e. investment disputes, would also make a good sovereign debt restructuring mechanism (SDRM). In fact, mainly in the sovereign debt debate, ICSID has been mentioned time and again as a potential insolvency forum.[1] Whether this may have been motivated by its affiliation with the World Bank or because of a general feeling of its over-all success is not always clear. It is interesting, however, that the ICSID community, if I may thus call arbitrators, counsel and academics working in and writing on that field of investment law, has largely ignored, if not outright rejected, this potential role. ICSID tribunals like the one in the *CMS* case[2] have expressly rejected a general competence to adjudicate on general economic policy measures such as debt moratoria. According to the *CMS* Tribunal, they do "not have jurisdiction over measures of general economic policy adopted by [States] and cannot pass judgment on whether they are right or wrong." Instead, its jurisdiction was narrowly construed "to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[3]

This is all the more surprising, given the ever increasing scope of ICSID jurisdiction and thus its potential also for creditor claims against sovereign debtors.

Mr *Szodruch* has skillfully outlined the possibilities of ICSID in this regard and I agree with almost everything he says there. Still, as a commentator I feel a certain need, not necessarily to disagree or criticize, but at least to emphasize that there might be some considerable jurisdictional obstacles both *de lege lata* and *de lege ferenda* left.

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1 See *S. L. Schwarcz*, Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach, 85 *Cornell L.R.* 101 (2000).

2 *CMS* v. *Argentina,* Decision on Jurisdiction of 17 July 2003, Case No. ARB/01/8, 42 ILM 799 (2003).

3 *CMS* v. *Argentina, supra* note 2, para. 33.

Let me first turn to the question of *ratione materiae* jurisdiction of ICSID panels over loan and other debt claims. It is said in the paper that the "traditionally broad investment definition of Art. 25 ICSID encompasses loans and bonds, whether issued by private or public entities"[4], while it might be more questionable whether sovereign debt would always be covered by BIT definitions of investment.[5] Indeed, some BITs contain rather restrictive language with regard to the definition of investment which implies that the usual forms of sovereign debt would not be protected.

However, I would submit that it is still also a genuine ICSID issue whether sovereign debt always falls under the *ratione materiae* jurisdiction of Article 25 of the ICSID Convention. It is true that, in particular, *Fedax*[6] is a strong precedent and supports the proposition that all sovereign debt should qualify as investment under the Convention. Nevertheless, if we follow the, by now well-established, practice of ICSID tribunals to require, in addition to qualifying under the investment definition of the applicable BIT, fulfillment of the Article 25 ICSID Convention criteria of "investment", as they have been elaborated in legal doctrine[7] and by the case-law of the tribunals,[8] I am not so sure whether duration, risk sharing, substantial commitment, etc. are all fulfilled in all cases involving sovereign debt. There are many short-term debt instruments with fixed interest rates which may escape the investment notion under the ICSID Convention.

Szodruch has rightly reminded us that also the issue of *ratione personae* jurisdiction may provide some problems for the use of ICSID as a forum to settle sovereign debt disputes. The requirement that the private creditor has to have the nationality of a State party to the ICSID Convention and, since ICSID clauses are practically non-existent in bond or loan agreements, also of a BIT-partner of the debtor State may lead to rather fortuitous results. This is only exacerbated by the fact that most modern debt instruments are constantly publicly traded on the international financial markets which will make the precise holders of debt claims at a specific point in time sometimes hard to ascertain. The suggestion that MFN clauses could mitigate the problem that debt claims might have to be treated differently, always according to the applicable BIT between the sovereign debtor and the (national) groups of creditors,[9] would not solve the fundamental problem that some creditors may not have any access to investment arbitration at all because there is no

4 *Szodruch*, p. 148.
5 *Idid*., p. 149.
6 *Fedax* v. *Venezuela*, ICSID Case No. ARB/96/3, ICSID Decision on Jurisdiction of 11 July 1997, 37 ILM 1378 (1998).
7 According to *Schreuer*, The ICSID Convention: A Commentary (2001), 140, the typical features an investment would normally exhibit are a certain duration, a certain regularity of profit and return, an element of risk for both sides, a substantial commitment and a significance for the host State's development.
8 See *Joy Mining Machinery Limited* v. *Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction of 6 August 2004, 44 ILM 73 (2005), para. 53.
9 *Szodruch*, p. 151.

BIT in force. In addition, apart from a State's private creditors, an entire group, i.e. its public creditors, is necessarily left outside the venue of ICSID, whose *ratione personae* jurisdiction can only extend over "a Contracting State [...] and a national of another Contracting State"[10]. This contrasts with today's practice of debt relief in the form of restructuring and rescheduling of a State's (public and private) external debt, mainly achieved in the so-called Paris and London Clubs. ICSID could cover only private debt in this terminology, i.e. debts vis-à-vis private creditors who must be regarded as investors in order to qualify as potential users of the ICSID system. Admittedly, during the last 20 years public debt has become less important in relative terms compared to the recent surge of public financing through bond emissions. Still, the problem remains that ICSID could not "adjudicate" the claims of public creditors. This necessarily narrow jurisdictional scope of ICSID must be regarded as an inherent disadvantage for its potential use as an insolvency mechanism which is true not only *de lege lata*, but also *de lege ferenda*.

Let me thus now turn to the core policy issue relating to the question whether it would be feasible for ICSID to perform functions of a SDRM, i.e. restructuring the (private and public) external debt of sovereign States, and what kind of changes would be required for that purpose. The main task of a SDRM is the effective restructuring of a sovereign's debt enabling it to continue to operate and guaranteeing equal treatment to creditors. This requires compulsory jurisdiction over all creditors. ICSID, however, has just "random" jurisdiction over some creditors who seek to enforce their individual claims. There is no jurisdictional mechanism of forcing potential claimants to institute ICSID proceedings if they prefer not to sue or to sue elsewhere, as they are regularly entitled to under the dispute settlement clauses typically included in BITs. But even if all creditors chose to institute ICSID proceedings there is no compulsory consolidation mechanism which would guarantee a consistent outcome. Instead, parallel proceedings would result, with all the concomitant risks of conflicting or inconsistent outcomes, etc. To transform ICSID into a genuine SDRM with compulsory jurisdiction over all creditors of sovereign debtors by amending the ICSID Convention would be theoretically possible. There is, however, not only no indication of any political will to do so, it would also fundamentally change ICSID which has just started to establish a reputation as a well-functioning dispute settlement system for investment claims.

Instead of changing ICSID, one could consider other functions possibly performed by the Centre. Conceivably, the role of ICSID in situations of sovereign insolvency could be one of validating the existence of claims in first line. An effective SDRM would additionally require a forum competent to reduce the creditors' valid claims to a certain equal proportion and at the same time to achieve a debt discharge for the debtor State. Whether this central SDRM task could be performed

10 Article 25(1) ICSID Convention.

by the IMF or by a new international judicial or quasi-judicial body will be seen, but most likely it will not be ICSID.

Third-Party Participation (NGO's and Private Persons) and Transparency in ICSID Proceedings

Carl-Sebastian Zoellner[*]

A. Introduction

"Taking Stock After 40 Years," the title and purpose of the present conference, already suggests that at least de facto, there has to be a certain degree of transparency as regards the object of our scholarly attention – otherwise any stocktaking attempt would have to remain purely speculative and prove to be virtually impossible for all but those participants, among them my commentators, who have personally contributed to the emerging body of international investment law by sitting as arbitrators or by representing parties. Yet the question remains, to what extent, and on what basis, third-party participation and transparency have been incorporated in ICSID proceedings – and what the future perspectives of those concepts are.

When the International Centre for Settlement of Investment Disputes (ICSID) was created by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Convention),[1] some of its most important features represented clear and significant new developments in the realm of international law.[2] Third-party participation and transparency, however, do not fall squarely into this category: As far as procedure and organization are concerned, international investment dispute settlement in general has borrowed its main elements from the system of (private) commercial arbitration,[3] with ICSID being no exception to this rule. Compared to judicial proceedings before courts of law, commercial arbitration is generally characterized by significantly higher degrees of confidentiality and

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1 575 U.N.T.S. 159. The Convention was opened for signature in 1965 and came into force on 14 October, 1966.

2 Cf. *Lauterpacht*, Foreword, in: *Schreuer*, The ICSID Convention: A Commentary, xi (2001), who inter alia mentions the right of non-State entities to sue States directly, restrictions to State immunity, and the exclusion of the local remedies rule.

3 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 2, available at: http://www.oecd.org/investment.

privacy, by closed doors and often unpublished awards.[4] Accordingly, allowing parties to keep private the details of their dispute is routinely being viewed as one of the factors that give arbitration an advantage over court procedures.[5] This opacity not only appeals to private enterprises which fear exposure of business secrets, but scholars have also identified it as key reason why governments accept mixed arbitration in the first place.[6]

With regard to purely commercial arbitration agreed on between privates, deciding a case *in camera* without registration of the dispute or publication of the final award indeed does not offend fundamental principles of justice,[7] nor does it as such involve questions of democratic legitimacy.[8] Given the public policy implications of investor-state arbitration, where the proverbial "non-accountable three private individuals" scrutinize regulatory measures taken by legitimate governments, however, this might be very different for the kind of disputes ICSID has successfully administered in the last 40 years.[9] Therefore, in the context of international investment disputes, knowledge – implying the use of specialized *amicus curiae* expertise – and the accountability provided by publicity become key issues complementing confi-

4 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169 (*Weiler* ed., 2005); *Leahy/Bianchi*, The Changing Face of International Arbitration, 17(4) J. Int'l Arb. 19, 51 (2000); *Prütting*, Vertraulichkeit in der Schiedsgerichtsbarkeit und in der Mediation, in: Law of International Business and Dispute Settlement in the 21st Century – Liber Amicorum *Karl-Heinz Böckstiegel*, 629 (*R. Briner* et al. eds., 2002); *Lew*, The case for publication of arbitration awards, in: The Art of Arbitration – Liber Amicorum *Pieter Sanders*, 223, 224 et seq. (*Schultsz* ed., 1982). Privacy is concerned with limiting the rights of third parties (i.e. persons other than the arbitrators, the parties and possibly witnesses) to attend meetings, hearings and to generally know about or participate in the arbitration, while confidentiality refers to the obligation of arbitrators and the parties not to divulge information relating to the contents of the proceedings, relevant documents or the award itself. See *Lew*, Expert Report of Dr. *Julian D.M. Lew* in *Esso/BHP v. Plowman*, 11(3) Arb. Int'l 285 (1995).

5 Cf. *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 138 (2003); *Merkin*, Arbitration Law 1 (1991).

6 See, for instance, as regards states's acceptance of arbitration before the International Chamber of Commerce in Paris, *Böckstiegel*, Arbitration of Disputes between States and Private Enterprises, 59 Am. J. Int'l L. 579, 584 (1965).

7 Cf. *Blackaby*, Public Interest and Investment Treaty Arbitration, Paper delivered at ASA Swiss Arbitration Association Conference on Investment Treaties and Arbitration in Zurich (25 January 2002), reprinted in 1 Transnat'l Dispute Management (2004), available at: http://www.transnational-dispute-management.com/.

8 But see *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 135 (2003).

9 It should be noted, however, that of more than 120 cases submitted to ICSID, the vast majority were only submitted in the past few years – a trend indicating further dramatic increases in the future, see *Flores*, Energy and International Law: Development, Litigation, and Regulation, 36 Tex. Int'l L. J. 1, 8-9 (2001); *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1538 *et seq.* (2005) with further references.

dentiality and privacy.[10] To properly reconcile and balance these at times conflicting principles is the task an effective and legitimate institutional framework for investment dispute settlement needs to achieve. How does ICSID fare in this respect?

In order to answer this question, I will first of all introduce the various dimensions of transparency and briefly outline its history in international economic law (B.). Having set the analytical framework, I will turn to the development and current state of third-party participation and transparency in investment disputes administered under ICSID rules, comparing it to other investment dispute settlement mechanisms where appropriate (C.). Building up on recent changes ignited by the ICSID Secretariat Draft Proposal, I will then discuss benefits and potential costs of transparency in investor-state arbitration and evaluate the present developments against this background (D.).

B. Transparency in International Economic Law

I. The Notion of Transparency

In a recent article, transparency has been described as "egregiously overused and poorly understood buzzword."[11] Indeed, when looking at international law at large, it becomes apparent that not many terms refer to situations as different from each other as "transparency" does. First of all, transparency has gained considerable importance in the study of international relations. Given the fundamental structural changes in the international legal order, i.e., with a view to the notable shift from Westphalian sovereignty to an international law of cooperation and integration, states today face more and more obligations stemming from a rapidly growing number of international law instruments.[12] Transparency has been identified as key concept to ensure compliance with these obligations.[13] Because this paradigmatic shift arguably entails the partial transfer of sovereignty and previously national competences to international regimes, transparency also increasingly becomes subject of

10 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 170 (*Weiler* ed., 2005).

11 *Hale/Slaughter*, Transparency: Possibilities and Limits, 30 Fletcher F. World Aff. 153, 163 (2006).

12 *Delbrück*, Structural Changes in the International System and its Legal Order: International Law in the Era of Globalization, 11 Schweizerische Zeitschrift für Internationales und Europäisches Recht 1 (2001), *passim*.

13 See *Chayes/Handler Chayes*, The New Sovereignty 135-53 (1995); *Hansen*, Transparency, Standards of Review, and the Use of Trade Measures to Protect the Global Environment, 39 Va. J. Int'l L. 1017, 1060 (1999).

debates circulating around the democratic legitimacy of this phenomenon.[14] Furthermore, on the international, regional and national level alike, additional aspects of transparency currently enjoy high attention and are constantly gaining importance in the respective legal regimes.[15] Thus, generally speaking, the current discussion of transparency in international law can be grouped along three different contexts: (1) as a concept underlying obligations international law places on states' internal legal regimes and procedures;[16] (2) as a concept governing the relations between institutions and regimes of international law and (their) member states;[17] and (3) as a concept denoting the openness of institutions and procedures of international law, especially *vis-à-vis* international civil society.[18]

As far as the narrower field of international economic law is concerned, however, the notion of transparency is predominantly used in the last sense, i.e., to express criticism regarding the way agreements are negotiated, institutions are governed or dispute settlement operates – it is the very absence, the proverbial "lack of transparency" and the allegedly resulting legitimacy or democratic deficit which dominate

14 *Petersmann*, Time for a United Nations 'Global Compact' for Integrating Human Rights into the Law of Worldwide Organizations: Lessons from European Integration, 13 Eur. J. Int'l L. 621, 646 (2002); *Delbrück*, Exercising Public Authority Beyond the State: Transnational Democracy and/or Alternative Legitimation Strategies*?*, 10 Ind. J. Global Leg. Stud. 29, 42 (2003).

15 On the international level, for instance, transparency is currently at the center of the debate regarding the problem of corruption,. *Ouzounov*, Facing the Challenge: Corruption, State Capture and the Role of Multinational Business, 37 J. Marshall L. Rev. 1181, 1198 (2004); *Klich*, Bribery in Economics in Transition: The Foreign Corrupt Practices Act, 32 Stan. J. Int'l L. 121 (1996). On the regional and national level, the transparency principle is increasingly reflected in a right for citizens to access information, cf. *Riemann*, Die Transparenz der Europäischen Union: das neue Recht auf Zugang zu Dokumenten von Parlament, Rat und Kommission, *passim* (2004). But see *Bradley Pack*, FOIA Frustation: Access to Government Documents under the Bush Administration, 46 Ariz. L. Rev. 815 (2004).

16 *Zoellner*, Transparency. An Analysis of an Evolving Fundamental Principle of International Economic Law, 27 Mich. J. Int'l L. 579, 582 et seq. (2006); cf. also United Nations, Conference on Trade and Development, Transparency, Series on Issues in International Investment Agreements, UNCTAD/ITE/IIE/2003/4, 16 et seq. (2004), available at: http://www.unctad.org/en/docs/iteiit20034_en.pdf; *Hilf*, Power, Rules and Principles - Which Orientation for WTO/GATT Law?, 4 J. Int'l Econ. L. 111, 119 (2001).

17 *Mitchell*, Sources of Transparency: Information Systems in International Regimes, 42 Int'l Stud. Q. 109, 110 et seq. (1998); *Aceves*, Institutionalist Theory and International Legal Scholarship, 12 Am. U.J. Int'l L. & Pol'y 227, 250-51 (1997); see also *Abbott*, "Trust But Verify": The Production of Information in Arms Control Treaties and Other International Agreements, 26 Cornell Int'l L. J. 1, 40-45 (1993).

18 *Alvarez*, Hegemonic International Law Revisited, 97 Am. J. Int'l. L. 873, 876 et seq. (2003); *Stein*, International Integration and Democracy: No Love at First Sight, 95 Am. J. Int'l. L. 489, 493 (2001); cf. also *Long*, „Democratizing" Globalization: Practicing the Policies of Cultural Inclusion, 10 Cardozo J. Int'l & Comp. L. 217, 259 et seq. (2002).

the discourse over transparency in this field of law.[19] Focusing in further on investment dispute settlement, these concerns have not only aggravated civil society groups,[20] but they have also been voiced by officials working for the US State Department: "Conducting arbitrations implicating the public interest in conditions of secrecy is unacceptable."[21] Yet until the beginning of 1981, information relating to ICSID proceedings was not available to the public at all.[22] Thus, it becomes evident that the awareness of transparency and its role in state-investor arbitration has only evolved slowly.

II. Historic Development of Transparency in International Economic Law

While there is no historical study on the emergence of international norms on transparency and citizen participation, *Immanuel Kant*'s coining of the phrase "capacity for publicity" in his essay Perpetual Peace certainly comes to mind as a key moment.[23] According to *Kant*, the "transcendental formula of public right [requires that] all actions that affect the rights of other men are wrong if their maxim is not consistent with publicity."[24] A first intergovernmental step to provide for some transparency on the international level was Art. 18 of the Treaty of Versailles,[25] following President *Wilson*'s famous call for "open covenants of peace, openly arrived at" instead of secret diplomacy.[26] From the current perspective, this develop-

19 *Head*, Seven Deadly Sins: An Assessment of Criticisms Directed at the International Monetary Fund, 52 U. Kan. L. Rev. 521 (2004); *Lacarte*, Transparency, Public Debate, and Participation by NGOs in the WTO: A WTO Perspective, 7 J. Int'l Econ. L. 683, 686 (2004); *Waincymer*, Transparency of Dispute Settlement within the World Trade Organization, 24 Melb. U. L. Rev. 797 (2000); *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817 (1998).

20 *Atik*, Legitimacy, Transparency and NGO Participation in the NAFTA Chapter 11 Process, in: NAFTA – Investment Law and Arbitration 135, 149-150 with further references (*Weiler* ed., 2004); cf. also *Hober*, Arbitration Involving States 139, 151, in: Leading Arbitrator's Guide to International Arbitration (*Newman/Hill* eds., 2003).

21 *Barton Legum* (then Legal Advisor to the U.S. State Department), cited in: The American Lawyer, Feature, 1 March 2002.

22 *Delaume*, ICSID Arbitration: Practical Considerations, 1(2) J. Int'l Arb. 101 (1984).

23 *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 928 (2004).

24 *Kant*, Zum Ewigen Frieden, in: Werke, Bd. 6, 326 (*Toman* ed., 1995) (1789).

25 Art. 18 required that all treaties be registered and then published by the Secretariat of the League of Nations, and stipulated that no such treaty or agreement would be binding until registered. See Treaty of Peace Between the Allied and Associated Powers and Germany, 28 June 1919, in: The Treaties of Peace 1919-1923, Vol. 1.

26 The citation is from the first of Wilson's fourteen points, *Stavasage*, Open-Door or Closed-Door? Transparency in Domestic and International Bargaining, 58 International Organizazion 667, 668 (2004) with an account of transparency's increasing role in international negotiations following World War I.

ment may have provided the necessary intellectual stimulus for the emergence of transparency as an issue in international economic law.[27]

As regards substantive provisions in international economic law, however, the first fundamental norm dealing with transparency did not concern the publicity of dispute settlement but another dimension of transparency: The Convention Relating to the Simplification of Customs Formalities (Customs Convention) subjected member states to transparency disciplines by mandating the prompt publication of all customs regulations and "clear and most definite" public notice of the conditions for export and import licenses.[28] The Customs Convention was also remarkably modern insofar as it explicitly expanded the group of beneficiaries to "persons concerned," which did not only include state parties but also domestic persons as well as aliens,[29] and provided for dispute settlement.[30] Furthermore, and probably most noteworthy, private parties played a significant role in the negotiating and drafting process.[31] The International Chamber of Commerce, for instance, exerted considerable influence on the formation of policy on the subjects of publicity and redress.[32]

More specifically with regard to investment dispute settlement, however, transparency's role remained limited for a long time. Even today many Bilateral Investment Treaties (BITs) and multilateral instruments like the Energy Charter Treaty do not require investors to publicly manifest their intention to launch a dispute, nor do they provide for the publication of awards or openness of proceedings – public disclosure thus often depends on the arbitral rules chosen by the parties or, in the absence of any regulation, on the will of the parties.[33] In this respect, the default rule stemming from investor-state arbitration's origins in commercial arbitration seems to be that unless neither party objects to it, no publication takes place and the pro-

27 *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 929 (2004).

28 International Convention Relating to the Simplification of Customs Formalities, 3 November 1923, 19 Am. J. Int'l L. Supp. 146 (1925), at art. 3(a) and art. 4.

29 *Id.*, at art. 4 para. 1.

30 *Id.*, at art. 7 and art. 22.

31 This at least holds true for organizations representing the business community, *Ridgeway*, Merchants of Peace 204, 207-08, 211 et seq., 216, 232 (1938); *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 929 (2004).

32 *Ridgeway*, Merchants of Peace 213 (1938).

33 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment.

ceedings remain closed.[34] Notable exceptions to this *confidentiality* rule are the most recent versions of the US and Canadian Model BITs.[35] In a similar vein, most investment treaties regularly do not contain rules piercing the *privacy* of the proceedings, i.e., governing the admissibility of *amicus curiae* submissions.[36] Again, the current versions of the US and Canadian Model BITs are prominent deviations from a general phenomenon.[37] Given this wide-spread lacuna, however, arbitral rules and framework norms such as those contained in the Convention gain crucial importance as far as third party participation and transparency of proceedings are concerned: In the absence of transparency provisions in the applicable substantive law, the procedural norms of the arbitration facility determine the degree of openness in the respective proceedings.[38]

34 *Collins*, Privacy and Confidentiality in Arbitration Proceedings, 30 Tex. Int'l L.J. 121, 122 (1995); *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 172 (*Weiler* ed., 2005). Whether there really is a presumption of absolute confidentiality, however, is subject to debate and influenced by the legal traditions at the place of arbitration. See *Bagner*, Confidentiality - A Fundamental Principle in International Commercial Arbitration? 18(3) J. Int'l Arb. 243 (2001); *Leahy/Bianchi*, The Changing Face of International Arbitration, 17(4) J. Int'l Arb. 19, 36 (2000); *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 959 (2003);. *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 125 et seq. (2003). Cf. also *Ali Shipping Corp. v. Shipyard Trogir* [1998] 2 All ER136 with *Esso Australia Resources Ltd and Others v. Plowman (Minister for Energy and Minerals) and Others*, 128 ALR 391 (1995).

35 See US Model BIT 2004, at art. 29, available at: http://www.ustr.gov/assets/Trade_Sectors /Investment/Model_BIT/asset_upload_file847_6897.pdf; Canadian Model Agreement for Promotion and Protection of Investments (2004), art. 38, available at: http://www.naftaclaims. com/files/Canada_Model_BIT.pdf. At least with regard to the United States, this development was inter alia prompted by the domestic Freedom of Information Act (FOIA), cf. *Loewen Group, Inc. and Raymond Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3 (Award), 26 June 2003, available at: http://www.investmentclaims.com. In any event, the US and Canada were also the first to undertake opening up NAFTA arbitration proceedings they are involved in, with Mexico joining later. See NAFTA Free Trade Commission Joint Statement on the Decade of achievement (San Antonio, 16 July 2004)), reprinted in: *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 17, available at: http://www.oecd.org/investment.

36 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 183 (*Weiler* ed., 2005).

37 See US Model BIT 2004, at art. 28 para. 2, available at: http://www.ustr.gov/assets/Trade _Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf; Canadian Model Agreement for Promotion and Protection of Investments (2004), at art. 39, available at: http://www. naftaclaims.com/files/Canada_Model_BIT.pdf.

38 Generally, the level of confidentiality in arbitration proceedings will be determined both by the applicable arbitration rules as well as the arbitration law at the place of arbitration. In addition, Art. 44 of the Convention emphasizes that it remains at the discretion of the parties to deviate from the default frame provided by the ICSID arbitral rules.

C. Development and Current State of the Game

I will thus now turn to the law governing the administration of investment dispute settlement proceedings by ICSID as it has developed and currently stands. With a view to the very recent changes brought about by amendments to the Arbitration Rules the Administrative Council adopted pursuant to Art. 6 of the Convention on 10 April 2006 ((ICSID Arbitration Rules),[39] this section will first sketch the normative framework effective before the amendments, then elaborate on the changes originally suggested by the ICSID Secretariat as well as on the actual amendments.

I. Third-Party Rights and Transparency at Relevant Stages of ICSID Proceedings Before the Recent Amendments

First of all, factors implicating transparency and third-party rights at various stages of the proceedings will be analyzed, i.e., norms pertaining to the registration of disputes, access to hearings, right to submit documents, and access to awards and other relevant documents. Relevant provisions can be found in the Convention itself as well as in Administrative Regulations and in the ICSID Arbitration Rules 2003. Corresponding norms in the ICSID Additional Facility Rules 2003 shall also be included in the survey.[40]

1. Registration of Disputes

When ICSID is chosen as a arbitration facility, the ICSID secretariat routinely applies a policy of registering all cases and publishes the register on its website.[41] According to the pertinent regulation, this register includes the names of the involved parties, the date of registration and a short summary of the dispute.[42] Administrative Regulation 23 (2) further clarifies that the register is open for inspection

39 See ICSID's website, http://www.worldbank.org/icsid/basicdoc/basicdoc.htm, for regulations and rules currently in force. Furthermore, references to the corresponding norms and rules pertaining to conciliation proceedings administered by ICSID will be provided in the footnotes. The rules effective before the recent amendments (hereinafter: ICSID Arbitration Rules 2003) are still available at http://www.worldbank.org/icsid/basicdoc/basicdoc-2003.htm.

40 The ICSID Additional Facility Rules have been amended effective 10 April 2006 as well, however, the rules effective prior to these changes (hereinafter: ICSID Additional Facility Rules 2003) are still available at: http://www.worldbank.org/icsid/facility/facility-2003.htm.

41 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment.

42 See ICSID Administrative Regulation 22 (1), available at: http://www.worldbank.org/icsid/basicdoc/basicdoc.htm.

by any person.[43] Such a detailed public register guarantees at least a minimum degree of transparency concerning current investment disputes; in this regard, the policy applied by ICSID is a noteworthy contrast to that of other institutions, such as for instance the International Chamber of Commerce (ICC) or Stockholm Chamber of Commerce (SCC), which both do not publish precise information about registration, number or content of administered investor-state arbitration cases.[44] Furthermore, as regards non-institutional *ad hoc* arbitration, the most commonly used UNCITRAL rules do not feature a registration requirement, either.[45]

2. Access to Proceedings

Under this heading, two facets of transparency can be discussed: (1) "passive" access to the hearings, for instance by means of broadcast or physical attendance, and (2) "active" access, i.e., the right of third parties to participate in the proceedings by submitting amicus curiae briefs.

a) Privacy v. Open Proceedings

Neither the Convention nor the ICSID Arbitration Rules 2003 contained norms providing for open hearings or access to submissions and other relevant documents absent party consensus. To the contrary, Rule 32 (2) ICSID Arbitration Rules 2003 explicitly stipulated that it was only with the consent of the parties that the Tribunal could allow third parties, i.e., "other persons besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the

43 *Id*., at Regulation 23 (2).

44 Consequently, there is only "anecdotal evidence" about the exact number of investment arbitration cases administered by these facilities, and "no one" likely knows the precise number of UNCITRAL cases, see *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1541 n.75, n. 77 (2005). The ICC does, however, publish general statistics about the number of requests for arbitration in the ICC Arbitration Bulletin and indicates the percentage of proceedings in which at least one party has been a "state, parastatal or public entity." See also http://www.iccwbo.org/court/english/right_topics/stat_2005.asp.

45 UNCITRAL has a secretariat, however, the latter has no mandate to register cases or keep data of the use of its rules by investors. *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment. It should also be noted that ICSID is increasingly offering administrative support in *ad hoc* arbitrations based on the UNICTRAL rules, see for instance recently the UPS case, *United Parcel Service of America v. Canada*, available at:http://www.investmentclaims.com.

Tribunal" to attend the hearings.[46] A similar rule had been included in the ICSID Additional Facility Rules 2003.[47] Given this univocal directive contained in the applicable rules, it was also clear that a Tribunal could not exercise its powers with respect to arbitral procedure to allow attendance by third parties against the will of the parties – they effectively enjoyed a veto right.[48] Finally, arbitrators had to sign a declaration that they "shall keep confidential all information coming to [their] knowledge as a result of [their] participation in the proceeding" before the respective tribunal can be constituted.[49]

Bearing in mind that the Convention explicitly leaves it up to the parties to decide on rules applicable in the proceedings,[50] however, it would have been nevertheless perfectly possible for the parties to agree on completely open proceedings both in conciliation as well as in arbitration cases brought before ICSID. Empirically, however, the necessary party consensus to open up ICSID proceedings or even publicly broadcast them has been missing – a stark contrast to a number of cases stemming from the investment Chapter 11 of the North American Free Trade Agreement (NAFTA)[51] which were decided under UNCITRAL rules.[52]

46 ICSID Arbitration Rules 2003, Rule 32(2), available at: http://www.worldbank.org/icsid /basicdoc/basicdoc-2003.htm. As to conciliation, the identical standard is laid down in Rule 27 (2) ICSID Conciliation Rules 2003. In addition, the rule's preceding paragraph holds that hearings shall take place in private and remain, unless the parties otherwise agree, secret.

47 See ICSID Additional Facility Rules 2003, Schedule B Art. 34 (1) and (2) (Conciliation), Schedule C Art. 39 (2) (Arbitration), available at: http://www.worldbank.org/icsid/facility/ facility-2003.htm. As to factfinding, Schedule A Art. 9 (4) lays down that sessions of the Commission "shall not be public."

48 For a recent confirmation of this state of affairs, see *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as Amicus Curiae (17 March 2006), para. 7, available at: http://www.worldbank.org/icsid/cases/ARB0317-AC-en.pdf (hereinafter*: Aguas Provinciales*); *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A., and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae* (19 May 2005), para. 6, available at: http://www.investmentclaims.com (hereinafter*: Aguas Argentinas*).

49 ICSID Arbitration Rules 2003, Rule 6 (2); ICSID Additional Facility Rules 2003, Schedule C Art. 13 (2); cf. also ICSID Conciliation Rules 2003, Rule 6 (2); ICSID Additional Facility Rules 2003, Schedule B Art. 13 (2), available at: http://www.worldbank.org/icsid/basicdoc/ basicdoc-2003.htm and http://www.worldbank.org/icsid/facility/facility-2003.htm respectively.

50 See supra, note 39.

51 North American Free Trade Agreement, 17 December 1992, Can.-Mex.-U.S., 32 I.L.M. 289..

52 The pertinent NAFTA cases are UPS, supra note 46; *Methanex Corporation v. United States of America*, and *Canfor Corporation v. United States of America*, both available at http://www. investmentclaims.com.

b) Amicus Curiae Submissions

aa) Normative Framework

As far as the "active" access to proceedings is concerned, the general exclusion of third parties from the hearings was complemented by the fact that both the Convention and the ICSID Arbitration Rules 2003 did not arrange for submission of amicus curiae documents to tribunals; the relevant evidence rules were silent on this issue.[53] And again, until recently ICSID proceedings had not produced precedents comparable to NAFTA cases under UNCITRAL rules which confirmed that tribunals had broad authority to accept and consider submissions from third parties.[54] Because ICSID is one of the dispute settlement facilities investors may turn to in disputes arising under NAFTA,[55] however, this very well could have been different. In its 2003 interpretative note, the NAFTA Free Trade Commission (FTC) clarified that "no provision of [NAFTA] limits a Tribunal's discretion to accept written submissions from a person or entity that is not a disputing party."[56] Furthermore, Art. 44 of the Convention stipulates that "if any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question." Thus, if the admission of amicus curiae submissions were such a question of procedure, an ICSID tribunal would have been able to admit them even on the basis of the old rules, if it deemed the briefs to be helpful in justly deciding the dispute.

bb) Recent Jurisprudence: Aguas Argentinas and Aguas Provinciales

Such a reasoning has recently indeed been employed by the Tribunals in two ongoing arbitrations, *Aguas Argentinas* and *Aguas Provinciales*. In both cases, the state party agreed to allow amicus curiae submissions, whereas the claimant opposed such an opening up of the proceedings.[57] Acknowledging that neither the Convention nor the ICSID Arbitration Rules 2003 specifically authorized or prohibited the submis-

53 See ICSID Arbitration Rules 2003, Rules 33-37, available at: http://www.worldbank.org/icsid/basicdoc/basicdoc-2003.htm; ICSID Additional Facility Rules, Schedule C Rules 40-44, available at: http://www.worldbank.org/icsid/facility/facility-2003.htm.

54 *Amicus Curiae* submissions have been allowed in UPS and Methanex, cf. *Methanex Corporation v. United States of America*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "amici curiae", 15 January 2001.

55 NAFTA, supra note 52, at Art. 1120 Nr. 1 a).

56 *Free Trade Commission*, Statement on non-disputing party participation (October 2003), reprinted in: *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 15, available at: http://www.oecd.org/investment.

57 See *Aguas Argentinas*, supra note 49, para. 8, *Aguas Provinciales*, supra note 49, para. 9.

sion by non-parties of amicus curiae briefs while noting the absence of any precedent under ICSID Arbitration Rules 2003 granting this right, the Tribunals examined two questions: (1) Did they have the power to accept amicus curiae submissions? and (2), if they had, what were the conditions under which this right could be exercised?[58] Even though at least in Aguas Argentinas the claimant specifically argued that allowing amicus curiae submissions would effectively introduce additional parties to the dispute and thus yield substantive consequences,[59] the Tribunals in both cases held that given the traditional concept of acting as "friend of the court" and its application in other forums, the question of amicus curiae submissions merely concerned an offer of assistance to the court regarding expertise and perspectives the parties themselves could not provide.[60] Furthermore, the Tribunals found support for their conclusion that the permissibility of amicus curiae briefs was a procedural question by comparing Art. 44 of the Convention with Art. 15 (1) of the UNCITRAL rules, which had been the legal foundation for amicus curiae participation in Methanex, and by looking at the practice of other international arbitral proceedings in the practice of NAFTA, the Iran-United States Claims Tribunal, and the World Trade Organization.[61] In sum, because the Tribunals were also convinced they could exercise their discretion to accept third party briefs without putting an increased burden on only one of the parties, they held that Art. 44 of the Convention indeed granted Tribunals the power to accept amicus curiae submissions from suitable nonparties in appropriate cases.[62]

Having decided that as a general matter they had the power to accept such submissions, the Tribunals had to answer the second question and develop conditions under which they may exercise this right. Accordingly, in order to balance the interest of third parties to be heard with substantive and procedural rights of the disputing parties, they established three basic criteria: (1) the appropriateness of the subject matter of the case; (2) the suitability of the given nonparty in the specific case; and (3) the procedure by which the amicus curiae submission is made and considered.[63] The first criterion refers to the public interest of a dispute, understood as cases in which the decision have the potential to directly or indirectly affect persons other than the disputing parties,[64] whereas the suitability of a given nonparty prima-

58 *Aguas Argentinas*, supra note 49, para. 9; *Aguas Provinciales*, supra note 49, para. 10.

59 *Aguas Argentinas*, supra note 49, para. 12.

60 *Aguas Argentinas*, supra note 49, para. 13; *Aguas Provinciales*, supra note 49, para. 13.

61 *Aguas Argentinas*, supra note 49, paras. 14-15; *Aguas Provinciales*, supra note 49, paras. 14-15.

62 *Aguas Argentinas*, supra note 49, para. 16; *Aguas Provinciales*, supra note 49, para. 16.

63 *Aguas Argentinas*, supra note 49, para. 17; *Aguas Provinciales*, supra note 49, para. 17.

64 *Aguas Argentinas*, supra note 49, para. 19; *Aguas Provinciales*, supra note 49, para. 18. In this context, the Tribunal also noted that increasing transparency in proceedings implicating the public interest also increased the legitimacy of international arbitral processes in general and ICSID in particular, see *Aguas Argentinas*, supra note 49, para. 22; *Aguas Provinciales*, supra note 49, para. 21.

rily depends on its expertise, experience, and independence.[65] When deciding on an application for leave as amicus curiae, the Tribunals would consider the opinion of the parties, the additional burden on parties, Tribunal, and proceedings as well as the degree to which the proposed amicus curiae brief was likely to aid the Tribunal in arriving at its ultimate decision.[66]

3. Access to Awards

In contrast to the issue of amicus curiae briefs and its original drafts, the Convention and the ICSID Arbitration Rules 2003 are perfectly clear as far as the publication of awards is concerned: Most fundamentally, Art. 48 (5) of the Convention mandates that ICSID may not publish awards without the consent of the parties; Administrative Regulation 22 (2) reiterates this principle.[67] Rule 48 (4) ICSID Arbitration Rules 2003 slightly but importantly refined this prohibition by adding that excerpts of legal rules applied by the respective Tribunal may be published by the Centre.[68] This modification was included in the 1984 revision of the ICSID Arbitration Rules and can be interpreted as a reaction to parties selectively disclosing information about past proceedings.[69] ICSID actively seeks and, statistically, obtains the consent of the parties to publish the full award in the ICSID Review – Foreign Investment Law Journal or, more recently, though its website in about fifty per cent of the cases.[70] Because Art. 48 (5) of the Convention is addressed to ICSID only, however, the parties remain free to make awards available to the public unless they have agreed otherwise.[71] Consequently, even if one party does not consent to ICSID publishing

65 *Aguas Argentinas*, supra note 49¸para. 24; *Aguas Provinciales*, supra note 49, para. 23.

66 *Aguas Argentinas*, supra note 49, para. 27; *Aguas Provinciales*, supra note 49, para. 26.

67 ICSID Administrative Regulations, Regulation 22(2). While first drafts leading up to the Convention were silent on the question of publication, a later suggestion to authorize the ICSID to publish the award "except as the parties otherwise agree" was changed into the prohibition currently in force. See *Schreuer*, The ICSID Convention: A Commentary, Art. 48 mn. 95 (2001) with further references.

68 ICSID Arbitration Rules 2003, Rule 48(4), available at: http://worldbank.org/icsid/basicdoc/basicdoc-2003.htm; see also ICSID Additional Facility Rules 2003, Rule 53 (3), available at: http://www.worldbank.org/icsid/facility/facility-2003.htm which in addition allows the registration of awards if this is required by the arbitration law of the country where the award is made. In conciliation proceedings, ICSID has no authority to publish the report, cf. Art. 33 ICSID Conciliation Rules.

69 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 MN 96 (2001); implicitly recognizing the challenge to provide a "balanced" account when information about proceedings is disclosed by parties or their counsel *Lalive*, The First 'World Bank' Arbitration (Holiday Inns v. Morocco)-Some Legal Problems, 51 Brit. YB of Int'l L. 123, 132 n.1 (1980).

70 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 4, available at: http://www.oecd.org/investment.

71 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 MN 100 (2001).

the award, the other party frequently releases it for publication in the International Legal Materials or other avenues.[72] Taken together with ICSID's competence to publish excerpts of the legal rules applied, at least the key holdings of all ICSID awards nowadays are available to the public.[73]

4. Access to other Documents (Decisions, Memorials, Minutes)

Even though Art. 48 (5) of the Convention literally refers to awards only, ICSID has always handled other (interim) decisions a tribunal may take, such as preliminary decisions on jurisdiction (Art. 41), procedural orders or recommendations of provisional measures, congruently, and will thus not publish them without the consent of the parties.[74] As far as their pleadings and other information about pending proceedings are concerned, publication remains at the individual discretion of the parties, i.e., absent an agreement to refrain from disclosure, they may unilaterally do so.[75] Given that the rules are silent on this issue, the unilateral release of such information had been subject of a request for provisional measures, however, the Tribunal refused to recommend provisional measures barring the public discussion of the pending case by the investor.[76] Very recently, however, for the first time in ICSID history, both parties of a case consented to the publication of their pleadings by the ICSID Secretariat.[77] Finally, as to the keeping of minutes of all hearings, the current version of the Administrative Regulations clarifies that the Secretary-General may only arrange for publication if both parties consent.[78]

5. Conclusion

Notwithstanding some policies supporting transparency, notably in terms of registration of disputes and publication of at least legal excerpts of awards, confidentiality and privacy notions stemming from its conceptual origins in commercial arbitration have dominated state-investor dispute settlement administered by ICSID. This holds

72 See, for instance, *AAPL v. Sri Lanka*, Award, 27 June 1990, 30 I.L.M. 577 (1991); *AMT v. Zaire*, Award, 21 February 1997, 36 I.L.M. 1531 (1997); *Fedax v. Venezuela*, Decision on Jurisdiction, 11 July 1997, Award, 9 March 1998, 37 I.L.M. 1378, 1391 (1998).

73 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 182 (*Weiler* ed., 2005).

74 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 mn. 105 (2001).

75 *Id.*, MN 107-111.

76 C. *Amco v. Indonesia*, Decision on Preliminary Measures, 9 December 1983, 1 ICSID Reports 410.

77 See ICSID, Documentation Regarding ICSID Case No. ARB/05/10, *Malaysian Historical Salvors v. Malaysia*, http://www.worldbank.org/icsid/cases/caseARB-05-10.htm.

78 ICSID Administrative Regulations, supra note 40, Regulation 22 (2) c).

particularly true as regards third party participation, which had not been envisioned by the normative ICSID framework at all. Considering the public policy implications of cases before mixed tribunals, this was a questionable state of affairs. Furthermore, it was also out of line with some of the more recent NAFTA cases brought under UNCITRAL rules and the underlying policy choices by the respective NAFTA member states which put an emphasis on transparency and third party participation.[79] Against this background, the fact that recently the Tribunals in Aguas Provinciales and Aguas Argentinas ruled they were competent to accept amicus curiae briefs even though one party opposed this step is all the more remarkable. As each award is only binding inter partes and cannot function as binding precedent on future Tribunals, however, Aguas Provinciales and Aguas Argentinas did not mitigate the general need for discussing potential reforms of the normative framework as such.

II. The ICSID Secretariat Draft Proposals

1. Discussion Paper

This need for discussion has also been recognized by the ICSID Secretariat: Reflecting on the practice of ICSID and responding to proposals made and concerns voiced by different parties, the ICSID Secretariat in 2004 issued a discussion paper on "Possible Improvements of the Framework for ICSID Arbitration."[80] In addition to topics such as interim relief, an increased role for mediation and the possible creation of an appeals facility, transparency and third party access to ICSID arbitral proceedings were raised as potential areas of improvement.[81] The ICSID Secretariat recognized that even though at least the key legal holdings of awards were eventually published under the then existing framework, requiring party consent for publication of the full award raises the issue of timeliness – oftentimes, several months pass before the Secretariat obtains consent of both parties.[82] Thus, speedy publication of the legal excerpts is all the more important. It therefore proposed to make timely publication of excerpts by the Secretariat mandatory.[83] Contrasting previous ICSID practice with the NAFTA cases mentioned above, the Secretariat moreover suggested amendments to the ICSID Arbitration Rules 2003 to clarify that – and under what conditions – panels have the authority to accept third party submissions

79 See NAFTA Free Trade Commission Joint Statement on the Decade of achievement, supra note 36.

80 ICSID Secretariat, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper, 22 October 2004, available at: http://www.worldbank.org/icsid/highlights/ DiscussionPaper.pdf.

81 Cf. *id.*, at para. 6.

82 *Id.*, at para. 12.

83 *Id.*

from, for instance, civil society organization, business groups, or other States parties to investment treaties concerned.[84]

2. Working Paper

Having received feedback from the members of the Administrative Council as well as from business and civil society groups, arbitration experts and institutions, the Secretariat finally in May 2005 presented a working paper including detailed suggestions how to amend the ICSID Arbitration Rules 2003 and Administrative Regulations.[85] Amending the rules and regulations only requires a majority of two-thirds of the members of the Administrative Council.[86] Although the proposals regarding access of third parties to the proceedings in particular elicited some disagreement, reactions to the preceding discussion paper had been generally positive.[87] Hence, it seemed most of the amendments suggested had a realistic chance to be realized.

a) Publication of Legal Excerpts

As far as transparency-related amendments are concerned, the ICSID Secretariat first of all suggested clarifying the wording of Rule 48 (4) ICSID Arbitration Rules 2003 to read: "The Centre shall, however, promptly include in its publications excerpts of the legal conclusions of the Tribunal."[88] Hence, this change aimed at introducing the qualifier "promptly" in the rule and making publication mandatory, thereby guaranteeing early release of such excerpts. A similar rule regarding the publication of full awards, however, is barred by Art. 48 (5) of the Convention and would thus require the unanimous decision of all contracting parties to amend the Convention.[89] This seems rather unlikely – in its discussion paper, the ICSID Secretariat itself noted that obtaining "unanimous ratification for an amendment by the 140 Contracting States would at best be a very long process."[90] Because it is applicable to arbitrations not governed by the Convention, however, a different situation

84 *Id.*, at para. 13.
85 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf.
86 See Art. 6 (1) of the Convention.
87 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf, para. 6.
88 *Id.*, 9. The corresponding art. 53 (3) of the ICSID Additional Facility Rules was to be changed accordingly.
89 See Art. 66 (1) of the Convention.
90 ICSID Secretariat, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper, 22 October 2004, para. 3, available at: http://www.worldbank.org/icsid/ highlights/DiscussionPaper.pdf.

arises with respect to Rule 53 (3) ICSID Additional Facility Rules 2003, which could very well be amended to indicate that, in cases of investment arbitration, awards shall be published by ICSID unless the parties agree otherwise.[91]

b) Access to Proceedings

In contrast to those pertaining to the publication of excerpts by the ICSID Secretariat, the proposed changes with regard to third party access to proceedings were more fundamental and the most controversial, for they would have drastically impacted the traditionally prominent role of party consensus in questions of procedure.[92] According to suggested amendments of Rule 32 ICSID Arbitration Rules 2003, allowing third parties to attend or observe parts or all of the hearings would have become a discretionary competence of the Tribunal.[93] While it would have had to consult "as far as possible" with the Secretary and the parties before exercising this competence, the final decision would have been vested with the Tribunal, which also would have had to establish appropriate procedures.[94] Moreover, the proposal undertook to fill the lacunae described above regarding amicus curiae submissions by amending Rule 37 ICSID Arbitration Rules 2003.[95] Analogous to the suggested competence as regards passive access, a new paragraph explicitly empowered the Tribunal to allow, "after consulting both parties as far as possible," third parties to file written submission with the tribunal. In accordance with the legal reasoning sketched above, the Secretariat described these latter amendments as clarification rather than as an expansion of the Tribunal's competences.[96] The proposed amendment obligated the Tribunal to consider, among other things, the extent to which (1) a potential third party's new insight, perspective or particular knowledge would aid the Tribunal in the determination of factual or legal issues; (2) the third party would address a matter within the scope of the dispute; and (3) the third party has a "significant interest in the proceedings."[97] Finally, the Tribunal would have to ensure

91 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev., 1521, 1602 (2005).

92 It is thus not entirely surprising that this part of the proposal has been "watered down" to safeguard a de facto veto of either party. See infra, part III.; cf. also *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/Itn_mar29_ 2006.pdf.

93 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf, 10. The corresponding Art. 39 (2) of the ICSID Additional Facility Rules was to be changed accordingly.

94 *Id.*

95 *Id.,* 11. Similar changes were suggested for ICSID Additional Facility Rules Art. 41.

96 *Id.*

97 *Id.*

that the submission would neither disrupt the proceedings nor unduly burden either party.[98]

III. The New ICSID Arbitration Rules

On 5 April 2006, ICSID issued a press release informing the public that voting by the members of the Administrative Council on "the amendments recently proposed by the Secretariat" had been concluded and that changes were expected to come into effect on 10 April 2006.[99] It is worth mentioning, however, that the final proposal actually voted upon differed in some key aspects from the previous versions of suggested reforms which had been tendered for public comment and that have been summarized above.[100] As a matter of fact, while voting on the amended proposals took place in late 2005 and early 2006, the text being voted upon was not released to the public at that time and has only recently been leaked – a few days before the official release of the adopted amendments.[101] In the context of changes intended to create a more transparent framework for improving the legitimacy and acceptance of the investor-state arbitration process, this may strike one as rather ironic.

Be that as it may, as far as substantive changes to the original ICSID Secretariat Draft Proposal are concerned, most notably the possibility for Tribunals to open up proceedings at their own discretion has been watered down significantly: Instead of leaving the decision after consulting "with the parties as far as possible" with the Tribunal, ICSID Arbitration Rule 32 (2) now features an introductory "Unless either party objects"-qualifier.[102] Therefore, parties still enjoy a de facto veto right, and accordingly, some commentators have already stated that this change between the old rules and the newly adopted ones was "hardly a big difference."[103] Indeed, the only difference seems to be that while before open hearings could only be instituted in case of an explicit consensus of the parties, it is now the absence of a veto that suffices, i.e., one could view the new system as one of an implicit "tacit consent" presumption. Nevertheless, effective party control of the privacy of hearings has been preserved by the member governments.

98 *Id.*

99 See ICSID News Release, Amendments to the ICSID Rules and Regulations (5 April 2006), available at: http://www.worldbank.org/icsid/highlights/03-04-06.htm.

100 See *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/itn_mar29_2006.pdf.

101 *Id*.

102 ICSID Arbitration Rules, Rule 32 (2), available at: http://worldbank.org/icsid/basicdoc/basic en.htm.

103 See *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/itn_mar29_2006.pdf, quoting *Schreuer*.

With the exception of the nixed competence of the Tribunal to grant passive access even in case of party opposition, however, the other changes with transparency implications originally proposed the ICSID secretariat have been adopted. That is to say, the modification regarding the mandatory and prompt publication of legal excerpts by the ICSID Secretariat as well as the clarification that Tribunals may accept amicus curiae submission where deemed appropriate have been approved and came into effect on 10 April 2006.[104]

IV. Conclusion

In sum, the adopted amendments corroborate the reasoning employed by the Aguas Argentinas and Aguas Provinciales Tribunals as far as amicus curiae submissions are concerned. The additional changes originally proposed by the ICSID Secretariat would have further parlayed the role of transparency by leaving the new possibility to open up hearings, even in the face of opposition by the parties, at the discretion of the Tribunal. This being said, it should not be forgotten that with a view to Art. 44 of the Convention, the parties always remain free to agree on different rules which should govern the arbitration. In other words, if both parties would have agreed beforehand to exclude third parties from the hearings as well as from submitting briefs, a Tribunal could not have referred to the proposed amendments in the ICSID Arbitration Rules and decide otherwise. This caveat notwithstanding, the suggested changes nevertheless would have had a significant impact, for unlike under the old as well as under the newly adopted rules, consensus of both parties would have been necessary to have *closed* hearings – a polar opposite to the hitherto existing situation and quite likely the reason why member governments (for now) declined to actually adopt this change and instead opted to preserve an effective veto right.

D. Perspectives and Limits of Transparency

When looking at the most recent versions of prominent national model BITs, disclosure policies applied by NAFTA countries, and recent practice of investor-state arbitration Tribunals as summarized above, one could conclude that there currently is a general trend towards transparency in international investment arbitration.[105] The amendments originally suggested by ICSID Secretariat and, at least partially, the changes actually adopted pick up on this trend. Some interested parties, however, oppose these developments for a number of reasons, inter alia because they are

104 Cf. ICSID Arbitration Rules, Rules 48 (4) and 37 (2), available at: http://worldbank.org/icsid/basicdoc/basic-en.htm.

105 *Legum*, Trends and Challenges in Investor-State Arbitration, 19 Arbitration International 143, 144 (2003).

perceived as unduly interfering with the principle that party consensus forms the basis of arbitration proceedings.[106] In the following, I will thus weigh potential benefits and problems of increasing transparency and third party participation in investor-state arbitration and assess in how far the proposed and adopted ICSID Arbitration Rules respectively represent a good compromise between the competing interests.

I. Benefits of Transparency and Third Party Participation

1. Knowledge, Expertise and Coherence

Dating back as a concept to Roman times,[107] the classical reason for allowing non-disputant parties to file amicus curiae briefs is to inform the court about additional aspects of a case which are important, but have not been reflected in the parties' own submissions – be it because they lacked the necessary expertise,[108] be it because as a party, their individual interest in the outcome of the case did not accommodate ramifications of a claim that concern "the public interest,"[109] be it because they deliberately chose to.[110] Therefore, third party participation is primarily deemed to increase the information available to a tribunal, thereby leading to a better informed and thus ideally better quality decision.[111] Against this background, common law systems embracing the concept of amicus curiae have traditionally restricted third

106 See *South Centre*, Developments on Discussions for the Improvement of the Framework of for ICSID Arbitration and the Participation of Developing Countries, South Centre Analytical Note, para. 41, available at: http://www.southcentre.org/tadp_webpage/research_papers/investment_project/icsid_discpaper_feb05.doc.

107 See *Angell*, The Amicus Curiae Brief: American Development of English Institutions, 16 Int'l Comp. L.Q. 1017 (1967).

108 Due to the increasing complexity of scientific risk assessment, the tension between risk regulation and investment treaty disciplines might be an area in which governments could indeed lack the degree of expertise highly specialized NGOs or individual experts can provide. In a similar vein, disputes in the realm of the World Trade Organization (WTO) have been heavily influenced by party submissions which included studies provided by NGOs and academics, *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836 (1998).

109 *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 956 (2003).

110 For instance, in the context of investor-state arbitration, general political considerations or the fear to create unfavorable precedent undermining the government's position in another pending case might keep parties from including certain aspects of a case in their pleadings, cf. in the context of amicus curiae participation in the WTO, *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836-837 (1998).

111 Cf. regarding the WTO, *Charnovitz*, Participation of Nongovernmental Organisations in the World Trade Organization, 17 U. Pa. J. Int'l Econ. L. 331, 351 (1996).

party submissions to a strictly informative, as opposed to a more advocating role – a "friend" is not a party.[112]

Transparency has another important "knowledge" dimension: It is only with awards being published that the knowledge of legal interpretations of clauses typically contained in investment treaties leaves the confines of a secretive "network of law firms" involved in these proceedings.[113] General access to awards thus levels the playing field and provides every potential party and their legal counsel with a wider array of jurisprudence to litigate with.[114] Furthermore, a closely related positive effect of transparency provided by published awards lays in its contribution to a more coherent formulation of international investment law: Even though commentators have cautioned to limit expectations about outcome predictability and emphasized the peculiar nature of state-investor arbitration, which features highly fact dependent doctrines and can thus produce different results in seemingly similar cases,[115] it can hardly be denied that insofar it is possible, both parties and tribunals regularly refer to the legal reasoning employed by prior tribunals. Thus, notwithstanding the fact that arbitration awards strictly speaking cannot create binding precedent,[116] publishing the legal reasoning and application of relevant doctrines in awards nevertheless fosters at least a certain degree of predictability and coherence as far as the interpretation of similar obligations contained in investment protection instruments is concerned.[117]

This is a very welcome development, not only because it aids tribunals themselves to consider more fully the legal issues at hand and to, as the case may be, issue a rational distinction based on reasoned opinions.[118] Just as importantly, the resulting predictability is vital for the effective functioning of the respective investment treaties, which are geared towards "increasing substantially investment oppor-

112 Regarding this distinction and the different schools of thought in US jurisprudence, see generally *Ford*, What are „Friends" for ? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 236-240 (2005).

113 *Blackaby*, Public Interest and Investment Treaty Arbitration, Paper delivered at ASA Swiss Arbitration Association Conference on Investment Treaties and Arbitration in Zurich (25 January 2002), reprinted in 1 Transnat'l Dispute Management (2004), available at: http://www.transnational-dispute-management.com/.

114 *Id.*

115 *Coe*, Toward a Complementary Use of Conciliation in Investor-State Disputes -- A Preliminary Sketch, 12 U.C. Davis J. Int'l L. & Pol'y 7, 21-22 (2005).

116 An award is binding only on the parties to the dispute and does not give rise to stare decisis precedent regarding the interpretation of a given clause or rule. This principle has also been stressed by the tribunal interpreting Art. 15 (1) UNCITRAL Rules in *Methanex,* see *Methanex*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," 15 January 2001, para. 51.

117 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1524, 1616-1617 (2005).

118 *Id.*, 1616.

tunities in the territories of the parties" by "ensuring a predictable commercial framework for business planning and investment."[119]

2. Legitimacy and Good Governance

While informing tribunals, counsels, parties and scholars as demonstrated is an important facet of transparency and third party participation, their public and scholarly discussion alike mostly center around the more prominent notions of democratic legitimacy, the "public interest" and good governance.[120] In fact, transparency has even been labeled "the most basic of good governance principles."[121] Why is this – and what does it mean for investment dispute settlement within the ICSID framework?

It is almost a truism by now that investor-state arbitration has the potential to significantly affect the "public interest."[122] This is not merely the case because one of the parties is a state,[123] however, it is due to the fact that the subject matter of many investment disputes impacts on the provision and costs of "public" services such as water, waste management, electricity or gas[124] or touches on the legality of domestic regulatory actions in sensitive fields such as environmental protection[125] and emer-

119 The quotes are taken from NAFTA's art. 102 para. 1 and preamble respectively, the underlying *telos,* however, is representative of any investment protection agreement. As to the economic investment incentives created by transparency, see generally *Zoellner*, Transparency. An Analysis of an Evolving Fundamental Principle of International Economic Law, part II.B.1, 27 Mich. J. Int'l L. 579, 587 (2006).

120 In this respect, see the often cited article by *DePalma*, NAFTA's Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say, N.Y. Times, 11 March 2001, Section 3, 1; cf. also *Ford*, What are „Friends" for ? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 209-211 (2005); *Soloway*, NAFTA's Chapter 11 - The Challenge of Private Party Participation, 16 J. Int'l Arb. 8, 10 (1999); *Gurudevan*, An Evaluation of Current Legitimacy-based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process, 6 San Diego Int'l L.J. 399, 425-427 (2005) with further references.

121 *Mann/Cosbey* et al., Comments on ICSID Discussion Paper "Possible Improvements of the Framework for ICSID Arbitration, International Institute for Sustainable Development (IISD), 8, available at: http://www.iisd.org/pdf/2004/investment_icsid_response .pdf.

122 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 220 (2001).

123 *Methanex Corp. v. U.S.*, Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," para. 49 (Jan. 15, 2001), available at: www.investmentclaims.com.

124 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 197 (*Weiler* ed., 2005).

125 *Hodges*, Where the Grass is Always Greener: Foreign Investor Actions Against Environmental Regulations Under NAFTA's Chapter 11, 14 Geo. Int'l L. Rev. 367, 385 (2001); cf. also *Wälde/Dow*, Treaties and Regulatory Risk in Infrastructure Investment, 34(2) J. World Trade 1, 17 (2000), generally discussing criticisms regarding binding international arbitration undermining domestic political processes and regulatory autonomy.

gency measures in times of severe economic plight.[126] Accordingly, these public interest implications create the need for public knowledge and, assuming that there was a general duty of confidentiality in arbitration, arguably for a public interest exception in investment dispute settlement cases.[127] By opening up proceedings to the public, publishing awards and allowing civil society's input by means of amicus curiae submissions, stakeholders will be more comfortable that their interests are being judged fairly and effectively.[128] Consequently, legitimacy and acceptance of binding investment arbitration processes, which offer claimants a uniquely strong "sword" compared to other international law instruments, will benefit.[129]

In terms of legitimacy and good governance, however, we should not focus too narrowly on the facilities and institutions of investor-state arbitration. To the contrary, from a good governance perspective, the legitimacy of involved governments depends at least as much on increased transparency in state-investor arbitrations as can be said with regard to the public acceptance of dispute settlement proceedings and Tribunals: As a prerequisite for accountability, transparency enables citizens to control the actions of their governments.[130] In the context of state-investor arbitration, this is significant for a number of reasons. For one, and most importantly, the public policy ramifications sketched above require from a democratic point of view that the position taken and the legal arguments made by governments in these pro-

126 Regarding the most notorious example of Argentina's pesification measures and resulting implications for ICSID arbitration and international investment law, see the contribution in this volume by *Szodruch*, State Insolvency – Consequences and Obligations under Investment Treaties; *Tietje*, Die Argentinien-Krise aus rechtlicher Sicht: Staatsanleihen und Staateninsolvenz, 37 Beiträge zum Transnationalen Wirtschaftsrecht 13-16 (2005).

127 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 221 (2001).

128 *Clark*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 852 (1998).

129 Regarding the connection between transparency and acceptance of investment arbitration, see *Methanex*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "amici curiae", 15 January 2001, para. 49. Concerning the perception that investment treaties and awards have moved from providing a "protective shield" against government overreaching to granting investors a "sword" to cut into domestic public protection laws, see *Jones*, NAFTA Chapter 11 Investor-to-State Arbitration Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared? 2002 B.Y.U.L. Rev. 527, 528 (2002).

130 As to the relation between information provided by transparency and accountability, see generally *Reuben*, Mandatory Arbitration: Democracy and Dispute Resolution: The Problem of Arbitration, 67 Law & Contemp. Prob. 279, 289 (2004); *Delbrück*, Diskussionsbeitrag zum Referat Hilf, 40 Berichte der Deutschen Gesellschaft für Völkerrecht 386, 387 (2003); *Bluemel*, Overcoming NGO Accountability Concerns in International Governance, 31 Brooklyn J. Int'l L. 139, 144 (2005); *Dunn*, Situating Democratic Political Accountability, in: Democracy, Accountability, and Representation 329, 335 (*Przeworski et al*. eds., 1999).

ceedings be available to the electorate.[131] Thereby, a control mechanism as regards the negotiation, conclusion, administration and concrete effects of investment treaties is established; ideally, the populace can respond to unwelcome developments at the voting booth. The vast potential effects investment disputes can have on the public purse bolster the need for accountability in this respect.[132]

More specifically, transparency in arbitration proceedings can prevent capture and successful rent-seeking by special interests and functions to reveal a government's responsiveness to genuine domestic preferences and democratic majorities.[133] As a matter of fact, the "filter function" governments traditionally assumed in international economic law,[134] i.e., the denial of amicus curiae submissions and direct third party participation in favor of "indirect" representation via government submissions necessarily mandates that domestic interest groups have the possibility to check whether their concerns are adequately reflected in government submissions.

II. Costs and Potential Problems of Increased Transparency and Third Party Participation

Having seen the benefits transparency and third party participation have to offer, I will now turn to costs and potential problems associated with increasing the openness of investment dispute settlement proceedings.

First of all, it should be noted that the very concept of transparency is one that is nowadays common to many western countries, but not necessarily rooted in other societies.[135] In a similar vein, the concept of amicus curiae is generally well-known

131 *Keohane*, quoted after *Bluemel*, supra note 131, 144: "Accountability refers to relationships in which principals have the ability to demand answers from agents to questions about their proposed or past behavior, to discern that behavior, and to impose sanctions on agents in the event that they regard the behavior as unsatisfactory."

132 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 220 (2001).

133 For a lucid discussion of the interconnectedness of transparency, accountability and the problem of capture using cost-benefit analysis, see *Hahn/Tetlock*, Using Information Markets to Improve Public Decision Making, 29 Harv. J.L. & Pub. Pol'y 213, 264 (2005).

134 *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836 (1998); *Ullrich*, No Need for Secrecy?, 34 U.B.C. L. Rev. 55, 59-60 (2000).

135 *Morrisson*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 860 (1998). For a critical account of the WTO transparency disciplines and their impact on developing states' systems of governance, see also *Wolfe*, Regulatory Transparency, Developing Countries, and the Fate of the WTO (March 1, 2003), available at http://www.cpsa-acsp.ca/paper-2003/wolfe.pdf.

to common law systems, but rarely found in the civil law legal tradition.[136] Therefore, increased transparency and amicus curiae briefs could have disparate impacts on parties with different legal backgrounds and, accordingly, different levels of experience in dealing with such briefs – a possibility that has caused some fear of unduly overburdening one party and thus interfering with a neutral and fair process.[137]

Worries about an undue burden are usually accompanied by the expectation that opening up the proceedings would likewise open up "floodgates" and cause uncontrollable numbers of submissions.[138] Given the limited financial resources particularly developing countries have at their disposal, there is some concern about their capacity to respond properly to a high number of amicus curiae submissions.[139] According to some commentators, this potential inequality is further aggravated by the difference in funding and experience as far as civil society and business groups in the industrialized world on the one hand, in developing countries on the other are concerned.[140]

In any event, to effectively manage potentially high numbers of amicus curiae submissions, conditions as to which third parties may file under what circumstances need to be established. While the traditionally informative role of amici curiae and their legitimizing function in arbitration proceedings implicating the public interest have been elaborated upon above, however, now a number of questions about their own legitimacy arise: If the traditional filter function of an elected government is abandoned in favor of direct submissions by interested groups, what does this mean in terms of democratic representation of the majority's will in a given country? How are such groups, many of which are not exactly characterized by internal transparency or democratic structures themselves, legitimized, given that they are not accountable to a constituency? Therefore, it could be argued that increasing transparency and allowing amicus curiae submissions opens the door for well-organized, vested interests to bypass the domestic decision making and lobbying process, making capture actually more instead of less likely.[141] Distinguishing between groups

136 With respect to amicus curiae submissions in the context of NAFTA, Mexico opposed allowing submissions because this would import a concept known to U.S. and Canadian parties, whereas Mexico, as a civil law state, had no experience in this regard. See *Methanex*, supra note 53, para. 9.

137 To counter such fears, tribunals ruling on their powers to accept amicus curiae submissions have emphasized the need to establish procedures safeguarding parties' equal rights. See for instance *Aguas Argentinas*, supra note 49, para. 29; *Methanex*, supra note 53, paras. 35 et seq.

138 *South Centre*, supra note 107, para. 37, refers to the recent case *Aguas Del Tunari v. Bolivia* (ICSID Case No. ARB/02/3), in which over 300 interested parties petitioned for the right to intervene, attend hearings, and receive full public disclosure of all evidence and pleadings. Cf. also *Carmody*, Beyond the Proposals: Public Participation in International Economic Law, 15 Am. U. Int'l L. Rev. 1321, 1346 (2000), arguing that "evidence does not suggest that the floodgates have opened to date."

139 *South Centre*, supra note 107, para. 37.

140 *Id.*

141 *Ullrich*, No Need for Secrecy?, 34 U.B.C. L. Rev. 55, 77 (2000).

which may legitimately file in a given case and those which may not, however, could prove rather difficult, burdensome and expensive.[142] In addition, one might point out that in private law disputes in many legal systems, amicus curiae briefs submitted by government agencies or organs are considered to give a voice to the public and deemed to address ramifications of a claim that go beyond the effects on the individual parties – that is to say, the very involvement of the government as such represents the "public interest."[143] From this angle, allowing third parties to address public interest issues in state-investor arbitration, where the government is necessarily already involved, might seem superfluous.

Finally, increasing transparency and allowing third party submissions represent a significant step in the process of judicilization of investment arbitration proceedings, i.e., moving it closer to "ordinary" litigation.[144] This development robs arbitration of two of its perceived core strengths, confidentiality and privacy, and might give rise to concerns about reputation among both private claimants and states involved.[145] Moreover, from a game theoretic point of view, it may cause problems in terms of posture and efficiency losses.[146] Accordingly, some commentators have already opined that due to this development, conciliation might be the preferable route to go in future investment disputes.[147]

142 This were only different if instead of including a set of criteria in the ICSID Arbitration Rules or leaving it generally up to the respective Tribunal, a working system of self-regulation and pre-selection among civil society actors could be established. See thereto generally *Rebasti/Vierucci*, A Legal Status for NGOs in Contemporary International Law?,7, available at: http://www.esil-sedi.org/english/pdf/VierucciRebasti.PDF.

143 See, for instance, the U.S. Federal Rules of Appellate Procedure 29 (a); cf. also *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 956 (2003).

144 Regarding this trend, see generally *Leahy/Bianchi*, supra note 5, 51-52.

145 In the case of states, the potential loss of prestige could further be accompanied by political repercussions, see *Böckstiegel*, supra note 7, 584. It is here submitted, however, that this is but one consequence of democratic accountability and thus as such no valid reason to uphold confidentiality in state-investor arbitration.

146 Transparency provided by open proceedings may particularly affect the negotiation of compromises or „amicable settlements" in the pre-hearing phase (see ICSID Arbitration Rule 21; ICSID Additional Facility Rules, Schedule C Art. 29 (2)), for under public scrutiny, no party can afford to give in on their initial stand. Generally as regards game theoretic costs of transparency associated with the "posture" problem, see *Stavasage*, Open-Door or Closed-Door? Transparency in Domestic and International Bargaining, 58 International Organization 667, 668 and *passim* (2004).

147 *Coe*, Toward a Complementary Use of Conciliation in Investor-State Disputes - A Preliminary Sketch, 12 U.C. Davis J. Int'l L. & Pol'y 7, 23, 26-27 (2005).

III. Evaluation of the Proposal and the Adopted Changes – The Perspectives of Increased Transparency

With a view to the possible costs and benefits of transparency and third party participation, how should the latest developments in the Aguas Argentinas and Aguas Provinciales arbitrations, the ICSID Secretariat Draft Proposal and the actual amendments be evaluated?

First of all, it is safe to assume that when the Contracting States signed the Convention, thereby consenting to investor-state arbitration, they certainly did not foresee possible future amendments to the ICSID Arbitration Rules creating a prior consensus requirement regarding *closed* proceedings or Tribunals exercising discretion as to whether admit amicus curiae submissions in spite of party opposition. As a matter of fact, even in the NAFTA context, where the US and Canada recently have been very active in promoting transparency, the third party to the treaty, Mexico, has only recently and rather hesitatingly joined some of the newly adopted policies.[148] In a similar vein, the ICSID Secretariat has been severely criticized for its initiative, for it were too political and bypassed the mandatory legal process for amending the Convention, a power which "rests with the political (sovereign) power of the Contracting States."[149] In this light, the developments represented by the ICSID Draft Proposal, by the adopted changes and by the Aguas Argentinas and Aguas Provinciales orders might indeed signal a possible changing of the tide as regards confidentiality and the consensus principle in investment dispute arbitration. This shift not only affects states, but it also concerns investors fearing loss of business secrets and, more importantly, a negative impact on their reputation – it should be remembered that in Aguas Argentinas and Aguas Provinciales, it was the private claimant who opposed third party participation. In any event, against this background, the fact that the Secretariat considered some of its suggestions merely "clarifications" and Tribunals have based their powers to allow third party submissions on interpretations of existing rules does not justify sweeping claims that this was a "phenomenon that has emerged with the consent of states, not in spite of them."[150] In my opinion, increasing transparency and opening up proceedings is a general trend which should not – and ultimately cannot – be stopped, even though member governments for now have refused to fully adopt all changes that were originally proposed.[151] What is nevertheless worth remembering in this context, however, is that the whole system of investor-state arbitration, notwithstanding more and more elaborate rules, at the end of the day depends on the good-faith application of rules and on the willingness of states to actually enforce awards. It is only in

148 See NAFTA Free Trade Commission, Joint Statement on the Decade of Achievement (San Antonio, 16 July 2004), supra note 36.

149 *South Centre*, supra note 107, paras. 16, 23-28.

150 *Hollis*, Private Actors in Public International Law: Amicus Curiae and the Case for the Retention of State Sovereignty, 25 B.C. Int'l & Comp. L. Rev. 235, 243 (2002).

151 See supra, note 93.

this regard that a state's "general and perpetual consent" to the system, its current evolution and potential future developments indeed remains vital.

That being said, the reforms suggested were rather moderate and well-balanced, their only partial adoption is thus somewhat disappointing. Mandatory publication of excerpts containing the legal conclusions of a case obligates the Secretariat and will have positive effects on coherence and predictability without infringing on parties' rights. The clarification that Tribunals may accept amicus curiae briefs is in line with the interpretation of the Aguas Argentinas and Aguas Provinciales Tribunals and seems dogmatically accurate. Conceptually, it is not a radical proposal, but a challenging proposal: In order to safeguard efficient, fair and balanced proceedings, Tribunals will have to carefully evaluate which third party submissions to accept and whether to consider the information contained therein. Moreover, Tribunals need to be aware of resource and timing issues and find a balance between public interest and traditional party control.[152] The indicated criteria are in my view adequate to ensure that neither parties nor the Tribunal are excessively burdened by the briefs and by and large conform with current practice of NAFTA tribunals operating under UNCITRAL rules, assigning a "quasi-expert" status to amici.[153] By doing so, Tribunals have acted very responsibly and limited third parties to an informative, "classic" amicus curiae role. This avoids some of the potential costs feared by opponents to third party participation, while preserving its benefits in cases with public interest implications. In contrast, a further-reaching "right" to have amicus curiae briefs considered or to even actively participate in pleadings, as sought and suggested by some commentators,[154] should even *de lege ferenda* not be granted. A friend is a friend is a friend – and not a party. Nor is it plausible to assume that amici could not make their points effectively through written submissions.[155]

As to the originally proposed right of the Tribunal to allow third parties to attend all or parts of the hearings, it may be argued that this would have been a more fundamental departure from traditional state-investor arbitration than the question of amicus curiae briefs. The fact that member government for the time being were not prepared to adopt such a measure would further support such a stand. Given the absolutely vital impact of such transparency on the legitimacy of the arbitration process and, in my eyes even more importantly, on the accountability of the governments involved, however, this development is – at least in the long run – unstoppable. In this respect, some of the arguments advanced against such openness,

152 Cf. with regard to dispute settlement in the WTO *Morrisson*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 860 (1998).

153 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 198 (*Weiler* ed., 2005).

154 See *Ford*, What are „Friends" for? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 253 (2005).

155 *Howse*, Kantor-Howse Exchange Regarding Restrictions on Public Access to ICSID Arbitrations, available at: http://gasandoil.com/ogel/samples/freearticles/article_57.htm.

such as possible detrimental effects on foreign investment if the defense brought forward by states was exposed to public scrutiny,[156] are quite telling and by themselves evidence enough that more openness is called for. As a matter of fact, it is debatable whether instead of opening the proceedings to additional groups of people, there should be a general presumption of open hearings.[157] In a similar vein, amending the ICSID Additional Facility Rules and, albeit an unlikely scenario, the Convention and ICSID Arbitration Rules to provide for the mandatory publication of complete awards would be a welcome development.

Taking everything into account, most, if not all, potential costs of increased transparency can be avoided if Tribunals carefully exercise their discretion in the fields of transparency and third party participation. And, because the parties choose their arbitrators and trust them to rule on the substantive issues, there is no convincing reason why tribunals should be unfit to properly manage these procedural competence as well.

E. Conclusion

We have seen that third party participation and transparency are important notions in the field of state-investor arbitration, yet in practice have traditionally been limited. The recent amendments following the ICSID Secretariat Draft Proposal and the orders in the Aguas Argentinas and Aguas Provinciales arbitrations, however, indicate an important change, which is in line a general development in investment dispute settlement arbitration. To conclude our discussion of transparency and third party participation in ICSID proceedings, the following theses sum up the issues covered:

Largely modeled after private commercial arbitration, rules governing state-investor arbitration have traditionally provided very little mandatory transparency and virtually no opportunities for third party participation. Consequently, increasing transparency and allowing third party input has been at the discretion of the parties, often requiring consensus. Insofar, the rules established by the Convention and the ICSID Arbitration Rules 2003 are more or less typical examples.

While it is debatable whether there really is a general and absolute confidentiality principle in commercial arbitration, keeping these proceedings and their outcome private does generally not encounter serious concerns with regard to public interest implications or democratic legitimacy. As far as state-investor arbitration is concerned, however, the often highly sensitive subject matter covered and possible

156 *South Centre*, supra note 107, para. 43.

157 *Mann/Cosbey* et al., Comments on ICSID Discussion Paper "Possible Improvements of the Framework for ICSID Arbitration, International Institute for Sustainable Development (IISD), 10-11, available at: http://www.iisd.org/pdf/2004/investment_icsid_ response.pdf.

wide-reaching ramifications of a case that go beyond the effects on the respective parties draw a different picture.

As a prerequisite for accountability, transparency is vital in ensuring the acceptance and democratic legitimacy of investment arbitration and the governments involved. Furthermore, it also fosters coherence in the emerging body of international investment law and functions as predictability-enhancing incentive for foreign direct investment. Amicus curiae briefs can offer unique perspectives, provide tribunals with additional expertise, and mirror civil society's take on issues bearing on the public interest.

Given both the public pressure for reform and the sketched benefits of transparency, the NAFTA parties have attempted to radically overhaul existing confidentiality rules and provide for more openness, thereby "judicializing" the arbitration process. This trend has been reflected in recent awards rendered under UNCITRAL rules. The ICSID Secretariat Draft Proposal and, to a slightly lesser extent, the changes actually adopted, pick up on this trend.

The reforms are rather moderate, well-balanced and should be applauded. Mandatory publication of excerpts containing the legal conclusions of a case as well as the clarification that Tribunals may accept amicus curiae briefs if suitable are not radical proposals and do as such not unduly infringe parties' rights. The originally proposed right of Tribunals to open proceedings, however, would have been more fundamental and would have constituted a necessary, highly important and welcomed step towards more accountability of governments involved. Therefore, even though the Administrative Council for now shied away from adopting this amendment, the necessary changes will only be postponed, not abolished.

Most, if not all, potential costs of increased transparency can be avoided. In order to safeguard efficient, fair and balanced proceedings, tribunals will have to carefully evaluate which third party submissions to accept and whether to consider the information contained therein. There is no reason not to trust their ability to do so. By contrast, a "right" to have amicus curiae briefs considered or to even actively participate in pleadings should not be granted.

In addition to the necessity of introducing open hearings, amending the ICSID Additional Facility Rules and, albeit an unlikely scenario, the Convention and ICSID Arbitration Rules to provide for the mandatory publication of complete awards would be a welcome development.

Transparency and Third-Party Participation in Investment Arbitration

Comment by *Karl-Heinz Böckstiegel*[*]

First of all, it should be noted that this Frankfurt Conference, so well organized by my colleague *Rainer Hofmann*, in spite of the many meetings now held worldwide on investment and particularly ICSID arbitration, by its program and also by the involvement of young brilliant researchers in addition to the "usual suspects", contributes efficiently to the many questions that still need comprehensive examination both academically and in practice.

And further, it should be noted that the paper presented by *Carl-Sebastian Zoellner* at this conference gives an insight and overview on information and discussion on the topic of transparency which has not been available so far and, therefore, will be very useful. This is so, irrespective of the fact that some in the field, including myself, may not agree with every conclusion he submits.

I am afraid my own comments, given more or less spontaneously at the Conference on the basis of my own experience as an arbitrator in investment cases, will have to be short, because the task of putting them on paper for this publication falls into a time in which other commitments accepted long before, many due to my investment arbitration cases, leave little time.

First of all, one has to recall that it is not by accident that arbitration, including international arbitration, has traditionally been *in camera.* The rise of international arbitration to the present situation where it is at least internationally the by far most frequently accepted method of dispute settlement in international trade and investment has been and is only possible by agreement of prospective parties to contracts or treaties submitting to arbitration. One of the main reasons usually mentioned for this submission is the confidentiality of the proceedings. This is particularly so for commercial arbitration between private enterprises, but also for arbitration between states and private enterprises.

In this context of course, one has to accept that states or state institutions or state enterprises may have additional political and/or legal responsibilities to give account of their contracts and disputes to the general public at large or at least to certain

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public administrative or legislative institutions. But, on the other hand, in most states such reporting duties are limited by law and practice, because one is aware that concluding and performing international contracts efficiently requires a certain degree of trust and cooperation between the parties which is not fit to every step and decision being the object of public discussion and justification in what easily may become a political debate. Similar considerations prevail for arbitration, where the efficient representation of a party's interests may be hindered by public and particularly political discussions and where due process and the administration of justice call for a de-politicized process in the view of both the states and the private enterprises involved.

There is no need to reiterate here the present status and the main considerations regarding transparency in international economic law and the development of the practice of ICSID and the recent discussion regarding ICSID proceedings well summarized by *Zoellner*. Indeed, in response to a respective invitation, I participated in that discussion on the future of ICSID by correspondence and in meetings in London and Washington DC. For good reason, proposals for more transparency of ICSID proceedings were put forward and have been taken into account by ICSID Tribunals and in the recent process of adopting amendments of various ICSID provisions that came into effect on 10 April 2006. As *Zoellner* rightly indicates in the updated version of his paper, the changes are limited:

- The new Rule 37(2) provides that Tribunals may accept *amicus curiae* submission.
- The new Rule 32(2) authorizes the Tribunal to allow third persons into the hearing "unless either party objects", whereby the parties still enjoy a *de facto* veto right.
- And finally, the new Rule 48(4) provides the mandatory and prompt publication of legal excerpts of awards by ICSID while the full publication of awards still remains subject to approval of the parties.

But in the context of this rather limited opening in comparison to the former version of the ICSID Rules, it should also be noticed that, in responding to much further going options presented by the ICSID Secretariat, the replies from the member states showed considerable hesitation to go "all the way" into full transparency of ICSID proceedings and admitting third parties and particularly national and international non-governmental organizations and interest groups to participate in case proceedings.

My own personal experiences as an arbitrator in investment arbitrations are limited in this regard and are obviously under the old version of the Rules. Over many years, there were no suggestions or attempts for more transparency or admission of third parties to proceedings in which I participated.

When I chaired the first NAFTA investment arbitration in the Ethyl Case, which was between a US investor and the Government of Canada, Mexico made use of the opportunity expressly provided for in NAFTA Chapter 11 and did submit additional briefs which our Tribunal took into account.

In one of my ICSID cases some years ago, though ICSID, according to its usual practice, asked the Parties for approval to publish our award and did not receive it from both parties, counsel of one of the parties put our award on the website of its law firm and, since the award was now public knowledge, no further action or sanction was taken.

In one of my other ICSID cases, since the case seemed to raise considerable public and political attention in the host state being the respondent in the proceedings, a national television station in that country asked for permission to bring live coverage of our hearing in Washington DC to the public in the host country. Making use of the Tribunal's discretion under (the old) ICSID Arbitration Rule 32, we decided that that provision seemed to imply an only limited attendance of hearings and that such a live coverage might change the character of pleadings and was not in the interest of an efficient procedure. Permit me to add that I also had difficulties imagining that a considerable television audience in a far away country would be interested to follow the technicalities of pleadings, procedural discussion and cross examination in a foreign language, English, in Washington DC.

In the same case, after the hearing *in camera* was concluded and the transcript of the hearing had been distributed to the Parties and the Tribunal, counsel of one of the parties put that transcript on the website of its law firm. When the other party objected, the Tribunal recommended to withdraw the publication from the website, and counsel complied with that recommendation.

Turning to NAFTA, after considerable discussion on transparency, particularly in the United States, NAFTA Chapter 11 investment arbitrations have become more transparent in a number of ways. The best illustrations are perhaps the wide scope of respective publication made available on all NAFTA cases involving claims against the United States on the website of the US Department of State which discloses comprehensive information including full texts of procedural documents,as well as the website *NAFTAClaims.com* operated by Prof. *Todd Grierson Weiler*.

On the other hand, one has to realize that, for decades, investment disputes have been and still are submitted to and decided under the rules of the well known institutions for international commercial arbitration such as the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA) and sometimes as well the rules of national arbitral institutions such as those of the Stockholm Chamber of Commerce (SCC). In fact, of the hundreds of new international arbitration cases started every year at the ICC, regularly more than 10 % involve states as parties. In all of these, the traditional confidentiality of the arbitration proceedings is maintained and – as I know from the many of such cases in which I have served as an arbitrator – the Parties insist on that confidentiality.

Zoellner repeats the distinction sometimes made that, in commercial arbitration, keeping the arbitral proceedings and their outcome private does generally not encounter serious concerns with regard to public interest implications or democratic legitimacy, while in state-investor arbitration, the often highly sensitive subject matter covered and possible wide-reaching ramifications of a case go beyond the effects on the respective parties. With all respect, from my experience, that distinc-

tion often is not valid. There are ICSID cases which deal with investments of relatively small importance for the respondent host state and small amounts in dispute, and commercial arbitration cases under the ICC and UNCITRAL Rules on major infrastructure construction, oil, nuclear and geothermal energy, telecommunication and similar investments of fundamental importance and high political attention in the host state for periods of up to 30 years and for amounts of several billion US-Dollars in dispute. It is hard to say that transparency is important for the former and not for the latter.

Thus, in conclusion, I submit that, on one hand, there are good reasons for more transparency in investment arbitration and more transparency has indeed been realized in recent amendment of relevant provisions and practice. But on the other hand, one has to realize that many parties including state parties consider confidentiality of the arbitral proceedings as important to them and may decide not to submit to arbitration rules that do not maintain that confidentiality. If we neglect such preferences of the parties, we may end up with transparent procedures satisfying understandable concerns, but not chosen by parties.

Opening the Investment Arbitration Process: At What Cost, for What Benefit?

Comment by *Noah Rubins*[*]

A. Introduction

I first became aware of the issue of "transparency" in investment arbitration in February 2002, not long after the conclusion of hearings in *Loewen v. United States*, when renowned American journalist *Bill Moyers* broadcast a television documentary called "Trading Democracy."[1] In the program, Moyers attacked the very idea of investment arbitration as an "end run around democracy," where "secret NAFTA Tribunals can force taxpayers to pay billions of dollars in lawsuits filed by corporations against the United States." The documentary focused in particular on the *Loewen* case, and expressed shock that "boutique" law firms (a group that expressly included the multinational firm of more than 2,000 lawyers to which I then belonged) were quietly challenging legitimate regulation and "local traditions" in the United States on the basis of "obscure" treaty provisions.

Continued pressure from various quarters, particularly within the NGO community, has given rise to a prolific discussion of the openness of investor-State arbitration proceedings.[2] Practical developments, both at the institutional level and on the part of individual treaty-based tribunals, have led to a level of publicity unprecedented in the annals of international arbitration, including consistently published awards, hearings accessible to the public, and the submission of *amicus curiae* briefs from non-parties. Despite the rapid change in this area, it appears that insufficient consideration has been given to the full scope of interests at stake in bringing so much light to the formerly somber recesses of extra-judicial dispute resolution, with a number of important issues simply taken for granted in the rush to protect the investment arbitration "system" from cries of foul from certain political forces and special interest groups.

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1 For a transcript of the program, *see* www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB65/transcript.html.

2 See, e.g., *Atik*, Legitimacy,Ttransparency and NGO Participation in the NAFTA Chapter 11 Process, NAFTA Investment Law and Arbitration 135 (*Weiler*, ed. 2004); *Mistelis*, Confidentiality and third Party Participation: UPS v. Canada and Methanex Corp v. United States, International Investment Law and Arbitration 169 (*Weiler* 2005); *Teitelbaum,* Privacy, Confidentiality and Third Party Participation: Recent Developments in NAFTA Chapter Eleven Arbitration, 2 The Law and Practice of International Courts and Tribunals 249 (2003).

Many of the proponents of increased public access and openness have relied extensively on the concept of "transparency." This is an understandable rhetorical approach: there is growing consensus among prestigious international institutions, and in particular the World Bank and OECD, that transparency is an essential element of good governance, for corporations and States alike. Transparency in the awarding of State contracts, for example, is understood to increase predictability and efficiency, reduce the incidence of corruption, and bring important benefits to the populations of developing States. So cloaking arguments related to investment arbitration procedure in the mantle of "transparency" promises a certain level of public support by analogy. But the adoption of "good governance" terminology cannot convert questions of dispute resolution procedure into questions of good governance. The issues and interests at stake are very different, and therefore it is important to use concepts appropriate to the task of objectively evaluating the need and modalities for additional openness in arbitral proceedings.

There are three very distinct types of so-called arbitral "transparency," each with its own characteristics, costs and benefits. The first involves *pre-award disclosure*, allowing the public access to oral and written arbitration proceedings. Pre-award disclosure has a number of aspects, from the publication of basic information about a dispute (already carried out systematically by ICSID with regard to the cases it administers), to circulation of pleadings and hearing transcripts (practiced until recently only in NAFTA cases),[3] to the ultimate pre-award openness, the right of the public to attend or observe oral hearings. The second form of arbitral openness is *post award* disclosure, *i.e.* the publication of awards and other information about a dispute once the proceedings have drawn to a close. The final type of "transparency," the most extreme and controversial, involves *privacy* rather than disclosure. By privacy, I mean to refer to the word "privity," the state of being a full-fledged participant in the dispute. In practice, the issue of privacy has been expressed through the debate as to whether non-party entities might be permitted to make *amicus curiae* submissions to an investment arbitration tribunal.[4]

Whether each of these three aspects of "transparency" (or "opacity," as the case may be) presents a problem to be addressed on a systemic basis (to the extent one can presume that we are dealing with a unified "system" – more on that later) is a question that should be answered only after a serious cost/benefit analysis. While the categories of cost and benefit are similar for each type of transparency, the magnitude of cost and benefit appears to differ for each. It is also important not to take for granted the different costs and benefits that accrue to the variety of different

3 For a recent example of this form of pre-award disclosure in the ICSID context, *see Malaysian Historical Salvors, SDN, BHD v. Malaysia,* ICSID Case No. ARB/05/10, http://www.worldbank.org/icsid/cases/caseARB-05-10.htm.

4 *Amicus curiae* submissions have become a limited but integral part of litigation before the WTOs Appellate Body. *United States–Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, WTO Appellate Body Report of 6 November 1998, paras. 105-108.

stakeholders in and around the investment arbitration "system." It should be uncontroversial that costs and benefits inure differently to investor-claimants, respondent States, national constituencies within the host state, arbitral institutions, non-governmental environmental protection organizations, etc.

B. The Perceived Advantages to Openness

The literature has identified three primary advantages to increased "transparency." These perceived benefits should not be taken for granted, but should rather be viewed with a critical eye.

I. Closing the Democracy Gap

Closing the "democracy gap" is the benefit most discussed, and was the one emphasized in *Bill Moyers'* television program, mentioned at the beginning of this paper. Investment treaty arbitration has adopted the structure and procedure of "private" commercial arbitration systems, with adjudication behind closed doors. This may be appropriate in the private context, where business conflicts have little impact on third parties, and where the public disclosure of sensitive commercial information or trade secrets may unnecessarily harm the parties. But in investor-State disputes, such secrecy is "un-democratic" (so goes the argument), because it can subject to critique the laws and regulations enacted by the duly-elected legislators or executives of the host State. But this discussion raises the question as to how broad this democracy gap really is. Is there not a range of activities related to democratic governance that are outside the public purview? And perhaps more importantly, how is the challenge of a regulation in treaty arbitration different in terms of public interest and impact on third-party interests from the challenge in commercial arbitration of the State's performance under a contract to buy public goods or services?[5] If the transparency of arbitration is to depend simply on "public interest," then separate rules will have to govern the process *whenever* a State is involved, not just in treaty cases.

II. Painting the Full Picture

A second often-cited benefit of arbitral "openness," primarily in the context of permitting *amicus curiae* submissions from non-parties, is that the arbitral tribunal will

5 Indeed, the courts in Australia have curtailed the confidentiality of arbitration in commercial cases that substantially affect the "public interest." *See Esso Australia Resources Ltd & Ors v Plowman (Minister for Energy) & Ors* (1995) 128 ALR 321.

be better able fully to understand the dispute before it once it has received information from sources other than the disputing parties. The theory is that both the claimant and respondent State have strategic and political interests that limit the scope of information and argumentation they will provide to the arbitrators. But while the parties to investment arbitration (and their counsel) are surely selective about the way they present their case, it stands to reason that each of them is best positioned to determine the optimal strategy to prevail.

Given that *amicus* submissions are normally submitted in support of one of the parties (most frequently the respondent State), it would seem that an *amicus* brief offering information extraneous to the supported party's submissions would threaten to undermine the very purpose for which it was created, interfering with the party's strategy for victory. Some observers contend that certain important information (the environmental impact of a measure or its absence, for example) is not at the disposal of the host State, or is ignored or discarded for reasons of bureaucratic capture. But these problems would appear best addressed from within the host State by the aspiring *amicus*. NGOs often have effective avenues to present their views and data to governments where they operate, and to ensure that this information is included in submissions.

It also stands to reason that the effectiveness of non-party submissions in providing a full picture of the dispute is largely a function of the wholesale opening of proceedings to public access. It is difficult to imagine an *amicus* brief that effectively fills the gaps in the parties' submissions, unless the submitting party has had the opportunity to scrutinize the case record. Therefore, in the absence of complete "transparency," with all of the incumbent difficulties and costs to the parties, it is questionable whether *amicus* submissions will advance the tribunal's analysis at all.[6]

III. Harmonization of Jurisprudence

The third primary benefit of transparency is the increased consistency of investment treaty jurisprudence. The threat of inconsistent decisions came to prominence in the wake of the *CME* and *Lauder* awards,[7] and has since found further impetus in other

6 See *Weiler*, Restrictions on Submissions of Amicus Briefs to NAFTA investment Arbitral Tribunals, TDM, February 2004.

7 *CME Czech Republic, B.V. v. Czech Republic*, UNCITRAL Partial Award of 13 September 2003 (finding Czech Republic liable for damages under Netherlands-Czech BIT); *Lauder v. Czech Republic*, UNCITRAL Award of 3 September 2001 (finding Czech Republic not liable under U.S.-Czech BIT). On the conflicting decisions, see *Bagner*, How to Avoid Conflicting Awards: the Lauder and CME Cases, 5 J. World Inv. & Trade 31 (2004).

pairs of cases where seemingly similar facts led to different outcomes.[8] Setting aside for the moment whether inconsistent decisions in investor-State arbitration pose a significant problem at all, it is questionable whether additional public access to arbitral documentation would in fact harmonize arbitration awards. For the time being, all arbitrators are instructed to decide only the case before them, with due regard to the absence of any rule of *stare decisis* in relation to awards rendered in other disputes involving other parties.[9] Until this fundamental rule changes, the increase of information about other tribunals and the basis on which they ruled should have little effect on the way tribunals adjudicate disputes. Moreover, arbitrators *already* have access to an unprecedented volume of prior decisions. Nearly every ICSID decision is available to the public within weeks or even days after it is issued. In the absence of binding precedent, is it really necessary or useful to ensure access to the voluminous submissions of the parties in prior disputes?[10]

C. The Costs of Openness

In addition to the limitations on the presumed benefits of arbitral openness described above, there are also potential costs that are insufficiently explored.

I. Politicizing Investment Disputes

Perhaps most important of these is the re-politicization of investment disputes. Investment treaties with direct recourse to arbitration were created precisely to eliminate the political element of economic disputes, which made outcomes unpredictable and unprincipled. In the words of *Horatio Grigera Naón*:

> International dispute settlement mechanisms are expected to provide a legal and technical - instead of a political - approach to the resolution of disputes regarding foreign investment. By advancing the resolution of disputes through the furtherance of principles of justice rather than politi-

8 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/01/13, Decision on Jurisdiction of 6 August 2003*; SGS Société Générale de Surveillance S.A. v. Republic of the Philippines,* ICSID Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004.

9 *See, e.g., Gas Natural SDG, S.A. v. Argentine Republic,* ICSID Case No. ARB/03/10, Decision on Jurisdiction of 17 June 2005, para. 36 ("The Tribunal wishes to emphasize that it has rendered its decision independently, without considering itself bound by any other judgments or arbitral awards").

10 It is a separate and valid question whether investment arbitration jurisprudence is, on the whole, less consistent than other legal systems, and whether lingering conflicts between individual case decisions are cause for serious concern. For the affirmative answer on both points, see *Franck*, The Legitimacy Crisis In Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521 (2005).

> cal accommodation (which may, of course, be pursued in parallel by other means) private international dispute resolution devices provide a better technical and appropriately depoliticized framework for the development of substantive law and principles regarding foreign investment protection likely to enjoy wide international consensus.[11]

The father of the ICSID Convention, *Aron Broches*, envisaged the investor-State dispute resolution system as way to create a more predictable and stable investment environment, and one in which disputes would be less likely to arise.[12] Whereas prior dispute resolution practices, such as diplomatic espousal, economic sanctions, and even gunboat diplomacy gave the advantage to economically and militarily powerful States, the new system was intended to place all States on equal footing, and to allow dispute resolution to occur on the basis of principle. Unfortunately, the litigation of disputes in conditions of complete publicity does not lend itself to such principled outcomes. Where parties are free to present their case to the "court" of public opinion, the risk of abuse and re-politicization is great. Of special concern is the possibility that claimant investors will relate an extreme and one-sided view of the facts underlying an investment dispute, imposing upon the respondent State the burden of criticism on a diplomatic level, immediate negative effects on external perceptions of its investment climate, pressure from international lenders, and other negative effects long before the parties' positions are assessed by an arbitral tribunal. In the worst case, an investor-claimant may initiate arbitration precisely with these effects in mind, hoping to obtain "nuisance value" compensation through extensive publicity, without regard to the actual merits (or absence thereof) of its claim.

A related and far from salubrious effect of re-politicization is the reduction of settlement opportunities. Since the foundation of ICSID, a large proportion of investment disputes have been resolved through amicable settlement before an award on the merits was rendered. Such an outcome is clearly in the interests of all the primary stakeholders, both in terms of arbitration cost savings, the possibility of preserving investment activities, and the elimination of any need to engage in enforcement of an arbitral award. But the early publication of extensive information about the merits of an investment dispute can result in the hardening of positions, particularly that of the respondent State. Government officials, particularly the mid-level bureaucrats who are typically charged with managing disputes with foreign investors, are subject to rather abstract pressures that can discourage settlement even in the most propitious circumstances. In a litigation proceeding, a result less than a total victory can be blamed on the arbitrator or judge, while the government official

11 *Grigera Naón*, The Settlement of Investment Disputes between States and Private Parties: An Overview from the Perspective of the ICC, 1 J. World Inv. 59-60 (2000).

12 *Broches*, The Experience of the International Centre for Settlement of Investment Disputes, International Investment Disputes: Avoidance and Settlement 75, 77 (*Rubin & Nelson*, eds. 1985). See also *Shihata*, Towards a greater Depoliticiztion of Investment Disuputes: The Roles of ICSID and MIGA, 30-32 (1993).

himself will have to take responsibility for any concessions included in a settlement agreement. This pressure is increased where public opinion has turned against the foreign investor, and therefore any compromise viewed as a betrayal of national interests. Likewise, where the investor levels allegations of mismanagement, corruption, or arbitrary conduct against the State and its officials, settlement may be tantamount to political suicide, perceived as (at least partial) admission of the facts alleged. It would seem that increased publicity (particularly one-sided and argumentative) can only intensify these forces, which form a significant barrier to amicable settlement in investor-State disputes.

II. Increased Time and Cost

Increased openness of arbitral proceedings is bound to have some effect on the speed and cost-effectiveness of the dispute resolution process. For less invasive types of "transparency," such as post-award disclosure of awards and pleadings, the added cost is minimal, and delay non-existent by definition. Other forms of public participation, in particular the submission and review of *amicus curiae* briefs, are of greater concern in this regard. The review of *amicus* submissions requires arbitrators first to determine whether a brief will be accepted at all, then a review of the submission once made, and finally an analysis of whether the contents of the submission should affect the tribunal's decision. Perhaps more significant still are the costs and time involved in the *parties'* review and response to non-party submissions. The resulting costs and delays are multiplied if a third party is given the opportunity to reply to critiques of its opinion raised by the parties.

Given the voluminous pleadings and massive legal costs already common in investment arbitration proceedings, and the burdens placed upon developing State respondents and small- to mid-sized corporate (or individual) claimants, even a modest increase in expense should be accepted only after careful consideration. Likewise, while speedy adjudication is hardly taken for granted in most investment arbitration cases, the delay caused by an additional round of briefing in response to *amicus* briefs could be significant.

III. De-Harmonization of the Procedural "System"

A final negative consequence of increased "transparency" that has received almost no attention is the introduction of additional heterogeneity into a procedural "system" that has already drawn criticism for its lack of internal harmonization. Mandatory public access to pleadings, awards, hearings, and the adjudicative process itself is generally accepted to require some adjustment to the treaty texts or procedural

rules governing investment arbitration.[13] Whether this will mean fundamental change to the Washington Convention, the ICSID Rules, or widespread alteration of individual consent documents such as model BITs, remains to be seen. Already certain modifications have been made to the ICSID Rules and, more drastically, to the U.S. Model BIT of 2004.

As these changes are implemented, the variations in procedural rules will widen between, for example, arbitration under the ICSID and UNCITRAL Rules, or pursuant to the BITs of the United States and the Netherlands. As a result, claimants will gain an additional (and unintended) advantage from their unilateral power to select the dispute resolution method of their choice. The risk of strategic behavior is particularly acute in light of recent jurisprudence granting "mailbox companies" access to BIT protections in certain circumstances.[14] A claimant who stands to benefit from broad publicity (a U.S. company investing in a less-developed country dependent upon U.S. foreign aid, for example) might seek arbitration at ICSID under the U.S. BIT, while a company preferring confidentiality (whether due to sensitive business information or skeletons in the closet) might choose UNCITRAL arbitration under a more traditional BIT through a corporate subsidiary of the appropriate nationality.

The result of this new facet of the "treaty shopping" problem is less predictability of both process and outcome. To the extent that investment arbitration is meant to stabilize the investment climate and provide both investors and States a view of how disputes are likely to be resolved, such a development would appear negative.

D. What Cost for Which Stakeholder?

With these (and other) costs and benefits in mind, does the balance tip towards increased openness, or the continued limitation of public access to investment arbitration? The answer to this question is likely to differ for each stakeholder in the arbitral process, *and* with respect to each of the three types of "transparency." This short presentation is not the place for a detailed analysis of the costs and benefits of each permutation of stakeholders and publicity, and below I suggest only a few relevant thoughts for consideration in this regard.

13 Naturally, the parties to a dispute are free to set the level of publicity for the adjudication of their dispute as they see fit. Moreover, tribunals have ruled that the applicable procedural rules (UNCITRAL and ICSID) provide them the authority to take certain steps in the interest of "transparency," should they deem such measures to be necessary and desirable. Most observers supporting increased openness, however, appear to favor a more systematic and mandatory approach to the issue, with a default rule implemented supporting public disclosure and the review of *amicus* submissions.

14 *See, e.g., Plama v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, para. 128 (under ECT, it is "irrelevant who owns or controls the Claimant at any material time").

The benefit of most concern to the *public at large* is clearly the closing of the much-touted "democracy gap." This defect is largely solved by post-award publication of decisions. It is for this reason that the general population in the only host State to experience "real time" opening of hearings – the United States – has reacted with disinterest to more extensive access. In the first investment arbitration with public hearings, for example, only four people attended. At the same time, the public bears very little of the direct cost associated with additional openness, except to the extent that pressure from publicity results in a disadvantageous settlement by their government. Naturally, such an outcome leads (in theory, at least) to an allocation of tax receipts that could otherwise be used to provide public services.

Non-governmental organizations, by contrast, glean only scant benefit from post-award transparency, since they focus upon influencing the outcome of particular arbitral disputes in accordance with the particular interests that they represent. Moreover, the "democracy gap" is of little concern to many NGOs, which are precisely created to overcome the under-representation of certain interest groups within the structure of democratic decision-making. NGOs do gain a significant benefit from pre-award publicity and the participation of non-parties in the arbitration process, since it is they who most often submit *amicus* filings.

For obvious reasons, *investor-claimants* gain only limited benefit from post-award publicity, since their efforts are centered on victory in the case at hand. Moreover, investors do not stand to derive significant advantage from the acceptance of *amicus* submissions. Most such filings are made on behalf of respondent States by non-governmental organizations, rather than by business groups. As explained above, however, the possibility of broad publicity before an award is rendered benefits claimants, in that the threat of disclosure can compel early settlement. The claimant bears little of the costs incurred as a result of this kind of transparency – most of which are carried by the respondent State. Of course, the claimant will have to pay part of the price for transparency, to the extent it results in increased legal expenses or delay in the rendering of an award.

Respondent States bear the brunt of the cost of increased pre-award publicity in investment arbitration. As noted above, the publication of factual allegations can increase pressure on respondent States in a number of ways. While accusations may run both ways, counterclaims are exceedingly rare in investment treaty arbitration. Therefore, it is primarily the respondent who will fear pre-award openness. In this regard, the increased risk of procedural abuse through the imposition and publicity of frivolous or exaggerated claims is an important cost. The respondent stands to benefit from the intervention of non-party actors, who tend to support the host-State position in their *amicus* submissions. But it is not always clear that such filings are wholly welcome, as they may be seen to distract from the more central aspects of the respondent government's defense.

E. Conclusion

The concern with pre-award transparency (and *amicus* submissions, which is founded upon the former kind of public access) is that investment treaties were devised to *de-politicize* investment disputes. Both claimant and respondent can attempt to use openness as a weapon contrary to this fundamental principle. Politicized disputes are less predictable in outcome than legal disputes, and therefore hinder FDI flows by making them more expensive. Moreover, the exposure during a dispute, and the resulting "parallel proceedings" in the court of public opinion hardens positions, exacerbates disputes, and makes amicable settlement less likely.

This is all above and beyond the relatively minor, but not insignificant cost of added time spent arranging for the reviewing third party submissions. In this regard, it seems logical that a system be devised for such intervenors to contribute to arbitration costs in exchange for the benefit they receive from *amicus* participation. Perhaps this is just part of the practical and logistical details that need to be worked out now that - supposedly - we are in consensus about the need for transparency. But such issues are likely to prove more difficult than has generally been recognized. Investment arbitration is not limited to adjudication within the ICSID system, and so amending the ICSID Rules is not enough. An inconsistency in confidential and privacy provisions between ICSID and UNCITRAL, for example, will only serve to deepen the heterogeneity of arbitration procedure of which the proponents of transparency already complain. Moreover, this variety of provisions can *only* benefit claimant investors, since it is their right in investment treaties to select from a menu of arbitration rules in accordance with their strategy in a given case.

All of this is not to say that awards - and *perhaps* pleadings – should never be made available to the public, after the close of arbitral proceedings. It would appear that the cost of such publication is minimal, and the potential benefit relatively great. The analysis for *pre-award* openness and de-privatization of the arbitration process is much more ambiguous. It appears that claimants stand to benefit most from such developments, and States who stand to bear the highest cost. This may be acceptable to the architects of the system, because: (1) States are *meant* to bear such a burden, because in return they receive a competitive advantage in FDI placement; (2) the third-party (*i.e.* public) benefit outweighs the cost; or (3) public pressure, not matter how irrational, is enough to bring the system crumbling down – a result that will adversely affect all stakeholders in the investment arbitration process. All this may be the proper result once the cost-benefit analysis has been undertaken. But the process has yet to begin, as most commentators have skipped to the end, presuming an answer that "feels right."

Is There A Need for an ICSID Appellate Structure?

Christian J. Tams[*]

A. Introduction

In October 2004, the ICSID Secretariat issued a Discussion Paper entitled "Possible Improvements of the Framework for ICSID Arbitration".[1] This paper came at a time when ICSID dispute settlement, judging from the number of pending cases, flourished. Yet the increasing number of proceedings not only signalled a general acceptance of the system, but also brought with it new problems – which the Secretariat apparently sought to tackle from a position of strength, by leading the debate about a number of reforms. The various measures suggested in the Discussion Paper were an interesting blend of purely technical issues and drastic measures of a far-reaching nature. Among the latter were proposals set out in Chapter VI and the Paper's Annex, in which the Secretariat showed itself prepared to "pursue the creation of […] an ICSID Appeals Facility",[2] and put forward rather concrete proposals for that option.[3] As commentators did not fail to observe, these proposals went to the heart of the ICSID system of dispute settlement and raised many issues of a fundamental nature.[4] In retrospect, it is curious how lightly they were raised. In fairness, it must be admitted that when suggesting the establishment of an appeals facility, the Secretariat responded to calls, by a number of ICSID member States (and notably the United States), for a reform of the existing dispute settlement system. Yet, the clear majority of ICSID participants voiced concerns during informal debates in late 2005 and early 2006, or even came out openly hostile against the idea. As a result, ICSID officials seem to have discarded any immediate plans for the creation of an appeals

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1 'Possible Improvements of the Framework for ICSID Arbitration' (22 October 2004), available on the internet: http://www.worldbank.org/icsid/highlights/improve-arb.htm.

2 *Ibid.*, para. 23.

3 *Ibid*.

4 See e.g. South Centre Analytical Note, 'Developments on Discussion for the Improvements of the Framework for ICSID Arbitration and the Participation of Developing Countries' (SC/TADP/AN/INV/1), available at http://www.southcentre.org.

facility, accepting that the earlier proposals had been considered by many as 'premature'.[5]

The present paper proceeds on the assumption that while temporarily off the agenda, the debate about an ICSID appellate system is not over. In fact, it may only be just beginning – but this time without the time-pressure that the Secretariat's reform proposal inevitably introduced. It is submitted that indeed, much more time is needed properly to evaluate the pros and cons of an appellate structure. The present paper seeks to contribute to that debate. It explores various arguments that might possibly militate in favour of a two-tiered system of dispute settlement (infra, section C.) but also assesses obstacles to such a reform (section B.), as well as alternatives to an appeals structure (section D.).

B. Obstacles

Before examining arguments that might support an overhaul of the present system, it seems necessary to discuss obstacles to reform. The present section addresses three rather different problems that any reform proposal must face. In very brief terms, these obstacles can be formulated in the following propositions:

- The ICSID dispute settlement system at present already allows for a review of awards in exceptional circumstances.
- The ICSID dispute settlement system deliberately restricted review to these exceptional circumstances, while otherwise stressing the need for finality.
- A reform of the ICSID dispute settlement system depends on stringent majority requirements and therefore requires broad political backing.

All three obstacles will be addressed in turn.

I. The Present System Permits a Review of Awards in Exceptional Circumstances

The first point to make is that even at present, there is some scope for a review of ICSID awards. When assessing that scope, it is necessary to distinguish between awards governed by the ICSID Convention proper, and those rendered under the Additional Facility Rules.

5 Investment Treaty News: 'ICSID Member-Governments OK watered-down changes to arbitration process' (29 March 2006), available on the internet: <http://www.iisd.org/ investment/itn/news.asp>. Cf. already the ICSID Working Paper 'Suggested Changes to the ICSID Rules and Regulations' (12 May 2005), available on the internet: <http://www.worldbank.org /icsid/highlights/sug-changes.htm>, para. 4.

1. ICSID Convention Awards

Awards rendered under the ICSID Convention can only be attacked by the procedures provided by the Convention itself. In particular, Article 54 of the Washington Convention obliges States to treat pecuniary[6] awards as if they were final judgments of the State's own courts. For the purposes of recognition and enforcement,[7] the ICSID Convention thus excludes any outside re-assessment of awards, or possibility of *vacatur*, by national courts. However, Article 54 is only part of the picture. It is one feature of a careful compromise struck during drafting. The other main feature is equally relevant and equally remarkable: internally, i.e. by mechanisms set out in the Washington Convention itself, ICSID awards *can* at present be reviewed. Unlike most other international dispute settlement mechanisms, the ICSID Convention not only recognises narrowly described forms of rectification, revision and interpretation of awards. In addition, Article 52 of the Washington Convention permits for a systemic review of awards in the form of an annulment procedure by *ad hoc* annulment committees. The scope of that annulment review has always been much discussed.[8] As the wording of Article 52 clarifies, there are five grounds of annulment: (1) the arbitral tribunal was not properly constituted; (2) it manifestly exceeded its powers; (3) a tribunal member was corrupt; (4) there was a serious departure from a fundamental rule of procedure, or (5) the award did not state the reasons upon which it was based.

At least at first glance, this list (which includes some rather vague notions such as "manifest excess of powers") may seem impressive. But Article 52 is important both for what it says and for what it does not say. While allowing for an unusual review procedure on five specific grounds, it implicitly excludes other forms of review.[9] In fact, clear evidence suggests that the drafters intended annulment to be an exceptional remedy and that the five grounds were to be narrowly construed.[10] More importantly, they were adamant that Article 52 should not be used as a form of substantive appellate review. In terms of the applicable standards governing systemic

6 The express reference to pecuniary obligations implies that non-pecuniary injunctions are not covered by ICSID's enhanced enforcement regime: see *Toope*, Mixed International Arbitration (1990), 245-246.

7 The Convention regime is less ambitious with respect to State immunity from execution: As Article 55 clarifies, Article 54 does not oblige States to enforce judgments which could not be enforced because of immunity from execution. For an explanation cf. the Report of the Executive Directors, 1 ICSID Reports, 32.

8 For the most detailed assessment see the commentary on Article 52, in: *Schreuer*, The ICSID Convention, and the various contributions in *Gaillard/Banifatemi* (eds.), Annulment of ICSID Awards (Huntington, 2004).

9 *Arnoldt*, Praxis des Weltbankübereinkommens (1997), 184; *Amadio*, Le contentieux international de l'investissement privé et la convention de la banque mondiale du 18 Mars 1965 (1967), 240.

10 For details see *Arnoldt*, Praxis des Weltbankübereinkommens, 184 *et seq*.

review, this means that Article 52 is only concerned with the procedural propriety of an award rather with its correctness as a matter of substance.[11]

Unfortunately, ICSID annulment committees have not always followed the text and spirit of Article 52. It is well known that at least some of them have taken a rather expansive view of their powers and have effectively used the concepts of 'manifest excess of power'[12] and 'failure to state reasons'[13] as stepping stones for a substantive review of the initial award.[14] While subsequent annulment decisions have adopted more restrictive approaches, it seems fair to say that the scope of Article 52 remains controversial.[15] It may simply be that Article 52, by requiring committee members to turn a blind eye on a potentially wrong decision, asks too much of highly qualified lawyers. But at least at the conceptual level, the limited nature of annulment under Article 52 is of crucial importance, and the distinction between annulment and forms of substantive review needs to be maintained. While not providing for a comprehensive appeals system, the Washington Convention thus regulates questions of review in a very differentiated manner, striking a careful balance between the need for finality on the one hand, and the possibility of review on the other.

2. Additional Facility Awards

ICSID Additional Facility awards are governed by a rather different regime. Since there is no equivalent to Article 52 of the ICSID Convention, Additional Facility awards are not subject to any internal review procedure comparable to annulment. However, they can be attacked externally, before national courts, where recognition and enforcement must be sought.[16] At the seat of the arbitration, national courts can be asked to set aside awards in *vacatur* applications. During enforcement proper,

11 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, Fordham Law Review 73 (2005), 1547; *van den Houtte*, Article 52 of the Washington Convention – A Brief Introduction, in: *Gaillard/Banifatemi* (footnote 8), 12; *Schreuer*, ICSID Convention (footnote 8), Art. 52 mn. 11.

12 Article 52(1)(b) ICSID Convention.

13 Article 52(1)(e) ICSID Convention.

14 For a detailed assessment of annulment jurisprudence see *Schreuer*, Three Generations of ICSID Annulment Proceedings, in: *Gaillard/Banifatemi*, (footnote 8), 17; *Schwartz*, Finality at What Cost?, *ibid*., 43. For highly critical reactions to the *Klöckner* and *Amco* annulment decisions see e.g. *Redfern*, ICSID – Losing Its Appeal?, 3 Arbitration International (1989), 98; *Reisman*, The Breakdown of the Control Mechanism in ICSID Arbitration, 1989 Duke Law Journal 739.

15 The debate between contributors to the volume edited by *Gaillard* and *Banifatemi* (footnote 8) testifies to this. Contrast e.g. *Schreuer's* positive assessment of the *Wena* and *Vivendi* decisions (e.g. at 18: "[T]he ICSID annulment process has found its proper balance.") with the highly critical pieces by *Schwartz* (43-86) and *Cremades* (87-95).

16 'Enforcement' is used here to include the recognition of the award; for a similar use of terminology see e.g. *Collier/Lowe*, The Settlement of Disputes in International Law (1999), 265.

respondents can ask national courts to refuse recognition – typically under the conditions set out in Article V of the 1958 New York Convention.[17] The rules governing these two forms of review are manifold.[18] But very simplistically, it can be said that awards can be reviewed for procedural defects broadly similar to the grounds of annulment set out in Article 52 of the ICSID Convention.[19] In addition, Article V(2)(b) as well as many national rules governing *vacatur* applications allow an award to be attacked if it and/or its enforcement is contrary to public policy.[20] This means that the scope for review is somewhat broader than under Article 52 ICSID Convention which deliberately opted against a public policy exception. Both under national laws governing *vacatur* applications and at the stage of enforcement proper, some courts have relied on public policy exceptions to perform a substantive review of awards. But these attempts are few and far between, and are difficult to bring in line with the overall aim of the New York Convention, which intends to enhance the prospects for enforcement.[21] Although applications of the public policy exception will often require national courts to look into the substance of an award, this means that enforcement should only be refused in highly exceptional circumstances. Again, this was a deliberate choice, aimed at preserving the integrity of arbitral awards, and at securing their enforceability.

II. The ICSID System Deliberately Opted Against Broader Options of Review

The previous considerations suggest that ICSID, already having some sort of review, may be an unlikely candidate for an appeals debate. But there is a second obstacle to reform, and that is the fact that the ICSID system deliberately opted against broader options of review. To some extent, this argument has been dealt with already, when discussing the scope of Article 52 of the Convention. Yet, rather than stressing the narrow scope of annulment (or of national court review, for that matter), one might equally underline the reasons leading ICSID drafters to restrict the options for review. Three such positive reasons can be distinguished:

17 330 U.N.T.S. 38. Similar provisions are included in the Inter-American [Panama] Convention on International Commercial Arbitration, OAS Treaty Series, No. 42.

18 For a more detailed assessment of the points made in the following see *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1548-1557.

19 See *Collier/Lowe* (footnote 16), 267-270, for further details.

20 For comment cf. *Toope* (footnote 6), 129-138.

21 In its Report, the New York Convention drafting committee noted that public policy exceptions could only come into play if enforcement would be "distinctly contrary to the basic principles of the legal system of the country where the award is invoked" (Report of the Committee on the Enforcement of International Arbitral Awards, 28 March 1955, UN Doc. E/2704 and E/AC.42/4/Rev.1.). For a detailed treatment of national courts' approaches see the ILA Study into the application of public policy by enforcement courts, eventually leading to a Resolution adopted at the ILA's 2002 New Delhi Session, both reproduced in International Law Association (ed.), Report of the Seventieth Conference (London, 2002).

- For a start, drafters were keen to establish a system that would solve disputes within a reasonable period of time[22] – hence their insistence on time-limits, and provisions preventing parties from frustrating proceedings.[23] The reason for this is not difficult to understand. Proceedings, whether judicial or arbitral, leave legal positions in abeyance and produce uncertainty. As a general matter, dispute settlement systems striving for efficiency should therefore seek to minimise the time spent on resolving legal and factual questions. In the case of investment arbitration, this rationale would seem to be particularly relevant.[24] Often, disputes concern important investment projects binding a relevant portion of a company's budget. By definition, investments prompting ICSID disputes also occur abroad, i.e. in a country in which the investor is not registered. Finally, as the sets of *Argentine* or *SGS* cases illustrate, parties (whether investors or States) may have entered into different contracts of a similar type, which means that one decision is likely to affect a variety of legal relations. Given these factors, the drafters were certainly correct in stressing the need for a reasonably quick resolution of disputes. Whether investment arbitration presently meets that goal is of course a matter for discussion. In contrast, it seems evident that whatever its design, an appeals structure would not reduce, but increase the amount of time lapsing before a definite decision on the merits. While much depends on time frames, it seems beyond doubt that introducing an appeals facility would complicate the task of resolving disputes quickly.
- The second point is related. It is based on a simple calculation: the longer the proceedings, the higher the costs. Again, much depends on the specific features of the appeals structure, but it seems clear that litigation in a two-tiered system is more expansive than with only one round of proceedings. This in itself is a potential drawback of a reform.[25] However, higher costs may have further implications: a more expansive litigation might deter smaller participants (whether smaller companies or poor States) from pursuing their rights.[26] It might there-

22 Cf. South Centre Analytical Note (footnote 4), para. 59.

23 Cf. e.g. Articles 45, 37(2)(b) and 38 of the ICSID Convention.

24 See *Tawil*, An International Appellate System: Progress or Pitfall?, Transnational Dispute Management 2/2005, 69 (70): "[I]nvestors require quick decisions as trust is a necessary requirement to be complied for investments to be done."

25 Cf. South Centre Analytical Note (footnote 4), para. 68: "A particular challenge, for developing countries, of the appeal facility is the cost of such a proceeding", noting that unlike in investment arbitration, "[t]he expense of the Appellate Body of WTO is born by the organisation itself" (*ibid.*).

26 Cf. *Wälde*, Alternatives for Obtaining Greater Consistency in Investment Arbitration: An Appellate Institution after the WTO, Authoritative Treaty Arbitration or Mandatory Consolidation?, Transnational Dispute Management 2/2005, 71 (74): "For a well-resourced government facing an under-resourced opponent (typically a smaller, entrepreneurial company with shallow pockets), an important strategy is simply to drain away the claimant's litigation war-chest until it is compelled to give up. Adding an appeal will reinforce the strength of such a litigation-resource based strategy."

fore act as an external factor harming the bargaining position of some ICSID participants.

- Lastly, ICSID drafters were prepared to place a considerable measure of trust in ICSID panels of arbitrators. They were convinced that an award, by these arbitrators, should be preserved at nearly all costs – hence the decision against any national court review and the narrow scope of annulment proceedings under Article 52.[27] This is not to suggest that their approach was the only acceptable one. However, it is a decision that was taken in 1965, and one that can certainly be described as fundamental to the ICSID dispute settlement system. Reversing it would not only mean a departure from the drafters' original intent. More importantly, the decision in favour of a second level of dispute settlement would also risk undermining the authority of the first level decision – i.e. the regular ICSID panels of arbitrators. If first-level decisions were regularly appealed, they might very well end up de-valued. In fact, experience with the WTO system of dispute settlement suggests that this is a risk that needs to be taken seriously.[28] In any event, that decision would show a considerable degree of distrust in the one level of dispute settlement in whose decision the Convention drafters deliberately placed great trust.

III. A Meaningful Reform Requires Broad Political Support

The preceding considerations suggest that both ICSID Convention and Additional Facility awards can be reviewed in exceptional cases, but are deliberately not subject to an appellate procedure. The proposed reform is therefore hard to reconcile with an essential feature of the present system. But there is a further, more practical obstacle: Meaningful reform proposals depend on stringent majority requirements. The degree of support required primarily depends on the type of appeals facility envisaged.

- The most ambitious proposal would be to introduce a single and comprehensive appeals facility competent to re-assess all awards rendered by ICSID tribunals. For that to be the case, the proposed appeals structure would have to be established by the very ICSID constitutional rules (whether ICSID Convention or Additional Facility rules). Unsurprisingly, this ambitious proposal faces the most serious problems of implementation. In the case of ICSID Convention awards, it would conflict with Article 53 of the Convention, which stipulates in no unclear terms that awards "shall not be subject to any appeal".[29] The most straightforward way of addressing this conflict would be to amend the Conven-

27 *Supra*, section B.I.1.

28 A statistical analysis shows that between 1995 and 2000, 77% of WTO Panel Reports were appealed: see *Park*, Statistical Analysis of the WTO Dispute Settlement System (1995-2000), in: *Petersmann/Ortino*, The WTO Dispute Settlement System (2004), 531 (541).

29 As *Sands/Mackenzie/Shany* observe (Manual of International Courts and Tribunals, 1999, at 90): "the exclusion of appeal is absolute".

tion. Pursuant to its Article 66, amendments require the ratification (or other form of approval) of each of the 143 member States. That far-reaching proposals should meet with a unanimous consensus however hardly seems realistic, at least in the short term. In the case of Additional Facility awards, matters would be less complicated, as there is no equivalent to Article 53. Still, Article 52(4) of the Additional Facility Rules (Schedule C)[30] declares awards to be "final and binding on the parties", which shows that the Additional Facility Rules envisage a one-level system of arbitration. To allow for a comprehensive system of appeals, they would thus have to be amended. While this would not require the support of all member States, it could only be done through a majority decision of the ICSID Administrative Council.[31]

- Given these majority requirements, it comes as no surprise that ICSID participants have begun to look for more feasible ways of allowing at least some parties to appeal some awards rendered by ICSID tribunals. These more realistic proposals would give up the goal of establishing a comprehensive appeals facility, and would open an appeals option for parties that jointly decide to avail themselves of it. The easiest way to do so would be to provide for an appeals option within the instruments establishing ICSID jurisdiction (typically bilateral or multilateral investment treaties). Alternatively, States could agree on a Protocol to the ICSID Convention specifically providing for appeals.[32] Legally speaking, nothing could prevent States and/or investors from so doing. As far as ICSID Additional Facility arbitration is concerned, parties of course are free to define the scope of ICSID arbitration, and could do so by establishing a second level of arbitration. With respect to ICSID Convention awards, these proposals would clearly circumvent Article 53, but would be justified as a valid inter-se modification.[33] Yet, while legally possible and politically more feasible, a system of appeals established under specific treaties might not be able to fulfil the hopes of those arguing for a reform of the ICSID system. This is a matter to be assessed more fully in subsequent sections of this paper,[34] but the main problem may be briefly referred to at this point already. If the appeals option depended on the provisions of investment treaties or a Protocol to the Convention, ICSID would offer a 'piecemeal appeal', open in some, but not in all disputes. If ap-

30 Available on the internet: http://www.worldbank.org/icsid/facility/facility.htm.

31 Cf. Article 6(3) of the ICSID Convention, which also served as the basis for the very establishment of the Additional Facility Rules. For comment see *Schreuer*, The ICSID Convention (footnote 8), Art. 6, mn. 23-26.

32 Cf. *Bishop*, The Case for an Appellate Panel and Its Scope of Review, Transnational Dispute Management 2/2005, 10.

33 Cf. Article 41 VCLT, pursuant to which an inter-se modification is permitted if it is not "(b) … prohibited by the treaty and: (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations; (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole."

34 *Infra*, section D.I.3.

peals structures were to be established by different investment treaties, there might eventually even be not one single, but different appeals facilities, possibly functioning according to different rules and standards.

C. Arguments for Introducing an Appeals Facility

The preceding section has sought to underline the difficulties to which the establishment of an investment appellate structure would give rise. The present section addresses arguments suggesting that notwithstanding these difficulties, the reform should be pursued. More specifically, it breaks down the different calls for reform into four (inter-related) arguments, and addresses each of them in turn.

I. An Appellate System Would Foster Consistency

The main argument supporting the establishment of an ICSID appeals facility is that such a facility could improve the consistency of international investment law. This argument is widely taken up by commentators. For example, in its discussion paper of late 2004, right at the start at the section considering an appellate structure, the ICSID Secretariat recognised that "the appeal mechanism would be intended to foster coherence and consistency in the case law"[35] (while also claiming that "[s]ignificant inconsistencies have not to date been a general feature of the jurisprudence of ICSID"[36]). Similarly, many commentators stress the need for an investment court of appeals uniting a seemingly fragmented body of law.[37] The propositions underlying this 'consistency argument' are that ICSID awards at present lack consistency, that this is a problem, and that an appellate body could solve it. All three issues will be addressed in turn.

35 ICSID Discussion Paper (footnote 5), para. 21.

36 *Ibid*.

37 See e.g. *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1617 *et seq*.; *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 10; *Goldhaber*, Wanted: A World Investment Court, The American Lawyer, Summer 2004 issue, available on the internet: http://www.americanlawyer.com/focuseurope/investmentcourt04.html. For earlier proposals see already *Holtzmann*, A Task for the 21st Century: Creating a New International Court for Resolving Disputes on the Enforceability of Arbitral Awards, in: *Hunter et al*. (eds.) The Internationalisation of International Arbitration: The LCIA Centenary Conference (1995), 111; *Schwebel*, The Creation and Operation of an International Court of Arbitral Awards, *ibid*., 115.

1. Are Investment Awards Inconsistent?

Disaggregating the issues, it is first necessary to assess whether there are at present inconsistent investment awards. The answer to this question is in the affirmative. At least in some instances, tribunals have rendered diametrically opposed or conflicting decisions, and have also openly criticised the reasoning of previous awards. As the cases are well-known, it may be sufficient to deal with them *en passant,* and to focus on the different types of inconsistency that they stand for.[38]

The *Lauder cases*[39] provide a spectacular example of opposite decisions by different tribunals, concerning the same set of facts, almost identical parties, and nearly identical legal norms. In fairness, it must be admitted that they were decided by UNCITRAL tribunals. Yet, their treatment may be justified here, as the decisions concerned substantive aspects of investment law not depending on a particular arbitral framework, and as they epitomise the problem of inconsistency. In essence, the two arbitral tribunals differed on the extent to which the Czech Republic had breached its obligations vis-à-vis a US American investor, Mr. *Lauder*, and a Dutch company (CME) controlled by him. A Stockholm arbitral tribunal found that the Czech Republic had committed an expropriation in the sense of Art. 5 of the Dutch-Czech BIT[40] when depriving CME of exclusive rights in the television business, holding that the relevant conduct (by the Czech Media Council) "smacks of discrimination against the foreign investor."[41] Faced with essentially the same expropriation standard in the US-Czech BIT,[42] the London tribunal held that the measures in question did not amount to an expropriation, as there had been no direct interference by Czech authorities, as Mr. *Lauder's* property rights had been maintained, and as the measure did not benefit the Czech Republic.[43] Based on their respective

38 For a more detailed treatment of the relevant awards see e.g. *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1558 *et seq*.

39 *CME Czech Republic B.V. v. Czech Republic*, Partial Award of 13 September 2001 and Final Award of 14 March 2003 (the 'Stockholm Award'); *Lauder v. Czech Republic*, Final Award of 3 September 2001 (the 'London Award'). All awards are available on the internet: http://www.investmentclaims.com/oa1.html. See also the subsequent decision by the Swedish Svea Court of Appeals, which decided not to vacate the Stockholm award: Judgment of 15 May 2003, available on the internet: http://www.investmentclaims.com/oa1.html.

40 Article 5 of the Netherlands-Czech Republic BIT provides that neither country "shall take any measures depriving, directly or indirectly, investors of […] their investments unless the following conditions are complied with: (a) the measures are taken in the public interest and under due process of law; (b) the measures are not discriminatory; (c) the measures are accompanied by just compensation."

41 Stockholm Award (footnote 39), para. 612.

42 Article III(1) of the US-Czech Republic BIT provides that: "Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (expropriation) except: for a public purpose; in a nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles or treatment provided for in Article II(2)."

43 London Award (footnote 39), para. 201.

reasoning, the Stockholm tribunal in its final award ordered the defendant to pay $355 million to CME, while the London tribunal refused to award Mr. *Lauder* any damages. Whatever the correct result, it is beyond doubt (and is widely accepted among commentators), that the contradictory result of the two Lauder cases has primarily had one effect: as was aptly put by one observer, it "brings the law into disrepute, it brings arbitration into disrepute - the whole thing is highly regretable."[44]

Instances like the different *SGS cases*[45] concern the conflicting interpretation, given by different ICSID tribunals, of a similar legal rule enshrined in different treaties, and applicable in similar cases between different parties.[46] The legal rules in question were versions of the much-discussed 'umbrella clauses',[47] contained in the BIT between Switzerland and Pakistan, and Switzerland and the Philippines. In different cases, ICSID tribunals had to assess whether this clause would transmute breaches of contract into treaty violations coming within the scope of the relevant BITs. In *SGS-Pakistan*, the tribunal adopted a narrow reading of the umbrella clause, which provided that host States "shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the Investors". Worried that each and every contract breach might be actionable before ICSID tribunals, it held there would have to be "clear and convincing evidence" that the State parties to the BIT intended to transform contract breaches into treaty claims.[48] In contrast, the tribunal in *SGS-Philippines* stressed the broad wording of the umbrella clause, by virtue of which a host State "shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other". While it sought to distinguish the formulations of the two umbrella clauses, presumably to avoid being chided for departing from earlier awards, the *SGS-Philippines* tribunal expressly criticised the award in the Pakistan case for inventing a presumption in favour of restrictive readings of umbrella clauses.[49] This suggests that the conflict between the two decisions cannot really be explained by the wor-

44 *Rushton*, Clifford Chance Entangled in Bitter Lauder Arbitrations, Legal Bus., Oct. 2001, 108 (cited in *Franck*, [footnote 11], Fordham Law Journal 73 [2005], at 1559). For similarly outspoken criticism see *Goldhaber* (footnote 37): "Czech taxpayers must think poorly of what passes for the world system of investment arbitration. […] The *Lauder* cases dramatize the tenuous legitimacy of investment dispute resolution."

45 *SGS Société Générale de Surveillance S.A. v. Pakistan*, Decision on Jurisdiction of 6 August 2003 ('*SGS-Pakistan*'); *SGS Société Générale de Surveillance S.A. v. Philippines*, Decision on Jurisdiction of 29 January 2004 ('*SGS-Philippines*'), both available on the internet: http://www.investmentclaims.com/oa1.html.

46 For a brief summary see *Gill*, Inconsistent Decisions: An Issue to be Addressed or a Fact of Life?, Transnational Dispute Management 2/2005, 12 (12-13).

47 On these see e.g. *Wälde*, The "Umbrella" Clause on Investment Arbitration – A Comment on Original Intentions and Recent Case, 6 Journal of World Investment &Trade (2005), 184-236; *Sinclair*, The Origins of the Umbrella Clause in the International Law of Investment Protection, Arbitration International 2004, Vol. 20 (4), 411-434.

48 *SGS-Pakistan* (footnote 45), para. 167.

49 *SGS-Philippines* (footnote 45), paras. 119-127.

ding of the respective treaties. In essence, the two tribunals adopted different interpretations of umbrella clauses. Taken together, the *SGS* decisions thus leave States and investors with a feeling of considerable uncertainty with respect to the meaning of such clauses.[50] Since the umbrella clauses were contained in *different* treaties, the tribunal's contradictory approaches, on a conceptual level, are not as problematic as the two *Lauder* cases.[51] But given the number of umbrella clauses within modern BITs, the practical consequences of the decisions are considerable.

Finally, a number of NAFTA cases shows that even when applying the same treaty norm, as opposed to identically-worded provisions of different treaties, arbitral tribunals do reach different conclusions. The different decisions in the cases of *S.D. Myers v. Canada,*[52] *Metalclad v. Mexico*[53] and *Pope & Talbot v. Canada*[54] are based on remarkably different interpretations of NAFTA's "fair and equitable treatment" clause, namely Article 1105. The *Metalclad* and *Pope & Talbot* tribunals seemed to consider Article 1105 to provide companies with a positive right existing independent, and going beyond, minimum standards of customary international law.[55] In contrast, in *S.D. Myers*, the tribunal took a different approach; it held Article 1105 to be violated when "an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective", thereby making Article 1105 dependent on general international law.[56] Again, for present purposes, it is not relevant to assess which of the tribunals took the correct approach. Rather, the three awards show that even within one and the same treaty system, different arbitral awards can create a level of uncertainty that is inimical to predictable and reliable dispute settlement.[57]

Of course, as always, there is a risk that by presenting three prominent examples, one might be taken to imply that these are the rule. It should therefore be underlined that in most cases, ICSID tribunals reach consistent decisions. Yet, even if they are exceptional, the instances of inconsistent decisions are noteworthy. They would seem to be more than occasional aberrations occurring within any system of law. Given the popularity of ICSID proceedings, their number is unlikely to decrease in

50 For subsequent decisions on the scope of umbrella clauses see the (non-ICSID) award, in: *Eureko v. Poland*, Partial Award on Liability of 19 August 2005; and the ICSID decision in *Noble Ventures v. Romania*, Final Award of 12 October 2005, both available on the internet: http://www.investmentclaims.com/oa1.html.

51 *Crawford*, Comment, Transnational Dispute Management 2/2005, 25.

52 *Myers, Inc. v. Canada*, First Partial Award of 13 December 2000 (UNCITRAL), available on the internet: http://www.investmentclaims.com/oa1.html.

53 *Metalclad Corporation v. Mexico*, Award of 30 August 2000 (ICSID), available on the internet: http://www.investmentclaims.com/oa1.html.

54 *Pope & Talbot Inc. v. Canada*, Award of 10 April 2001 (UNCITRAL), available on the internet: http://www.investmentclaims.com/oa1.html.

55 See *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1578-1581 for references.

56 *Myers* (foonote 52), para. 263.

57 For an attempt to influence the matter see the interpretative note issued by the NAFTA Free Trade Commission: 'Notes of Interpretation of Certain Chapter 11 Provisions' (31 July 2001), available on the internet: http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

the future. What is more, inconsistent decisions are clearly visible in a system now increasingly moving towards transparency and greater public scrutiny.[58] Since they will usually concern similar provisions found in different but similarly-phrased treaties, the contradiction between decisions will also be particularly evident. It remains to be seen whether the problem is a fact of life with which investors and States have to put up, or whether it could be remedied by the establishment of an appeals facility.

2. Is Inconsistency a Problem?

Inconsistent decisions need not necessarily be considered a problem. At least three arguments might suggest that it is not.

- *First*, one might take what might be called an "individual approach" to investment dispute resolution, and argue that the first task of a tribunal really is to solve the case rather than to worry about implications. This approach draws attention to one of the specific features of arbitration as opposed to institutionalised adjudication. Indeed, the dispute settlement system established under the ICSID Convention (or the Additional Facility Rules, for that matter), is there for the parties, and not for interested observers keen on systemic consistency. Yet, notwithstanding its correct starting-point, the individual approach is simplistic. It neglects that arbitration within the ICSID system is not purely *ad hoc*, but functions according to institutional rules laid down in the ICSID Convention and Rules. Perhaps more importantly, it ignores that – at least in practice – the ICSID dispute settlement has developed into a system characterised by personal continuity between different panels, frequent references to earlier awards (both in pleadings and awards), and intense peer discussion requiring arbitrators to justify deviations from previous decisions.[59] The day-to-day functioning of the ICSID system therefore defies the premises of the individual approach. Lastly, that approach also ignores that consistency also benefits the parties (and may be expected by them), as it reduces the uncertainty inherent in arbitral proceedings.
- *Second*, one might argue that with the large number of pending investment cases, some degree of inconsistency is normal.[60] Just like the first, this second argument proceeds from a correct starting-point, but is ultimately unconvincing. Of course, one could hardly expect arbitral tribunals to function like robots producing identical results in different cases – especially in a system of decentralised dispute settlement rejecting the concept of binding precedent and based on

58 A point stressed by *Gill* (footnote 46), Transnational Dispute Management 2/2005, 13.
59 Cf. also *Wälde* (footnote 26), 77.
60 *Gill*, Transnational Dispute Management 2/2005, 12 *et seq*.

tribunals on an *ad hoc* basis.[61] More generally, one might say that ICSID dispute settlement lacks 'hard' mechanisms for forcing tribunals to arrive at consistent decisions. But again, this does not mean that inconsistency in ICSID dispute settlement was unproblematic. Very simply, it is submitted that while some degree of inconsistency has to be accepted as normal litigation risk, the present degree of inconsistency is no longer a normal fact of life. Of course, there are few objective criteria measuring "normal" degrees of inconsistency. Yet, it may be helpful to compare ICSID experience to that of other dispute settlement institutions. True, those other bodies have also had to cope with inconsistent decisions. In public international law, for example, the ICTY's *Tadic* decision[62] caused an outrage, because it deviated from the ICJ's standard of attribution established in the *Nicaragua* case.[63] But despite the number of international tribunals, and the host of issues addressed by them, *Tadic/Nicaragua* has really been the one and only high-profile inconsistency.[64] In contrast, even on the basis of the few examples referred to, we can say that investment tribunals openly disagree; they do so frequently, and they do so on a variety of issues. The level of inconsistency reached in investment arbitration seems to be more than a fact of life.

- But there may be yet another reason explaining this high degree of inconsistency. It has to do with the fragmentation of substantive international investment law, and the dominance of specific investment treaties in particular. When applying treaty rules and arriving at different results, so the explanation runs, ICSID tribunals might simply give effect to the differing treaty standards – one might say that, fragmented as it is, investment law simply cannot be interpreted consistently. To take an example, while nearly all BITs prohibit expropriation, they need not all define expropriation in an identical way. If this were the case, inconsistent decisions would not be problematic, but rather to be welcomed. Once more, this argument highlights one of the specific features of investment law. It also enables us to distinguish between different types of inconsistencies. Clearly, it is more problematic for tribunals to interpret one and the same norm inconsistently, as happened with Art. 1105 NAFTA, or to give contrasting decision in *one* case (Lauder) than to interpret two similar, but different provisions (such as two umbrella clauses) differently.[65] However, this does not explain away the problem either. For once, notwithstanding the fragmentation of substantive investment law, there are concepts of general application. A tribunal

61 *Crawford*, Comment, Transnational Dispute Managemant 2/2005, 8 ; *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 9.

62 ICTY, Case IT-94-1, *Prosecutor v. Tadic*, ILM, vol. 38 (1999), 1518 (paras. 116-145).

63 ICJ Reports 1986, 14, 62-65 (especially paras. 109 and 115).

64 For a detailed treatment of the problem of fragmentation see e.g. *Buergenthal*, Proliferation of International Courts and Tribunals: Is it Good or Bad? Leiden Journal of International Law 14 (2001), 267; *Oellers-Frahm*, Multiplication of International Courts, Max Planck UNYB 5 (2001), 67 *et seq.*

65 *Crawford*, Comment, Transnational Dispute Management 2/2005, 25.

asked to interpret an umbrella clause will of course be guided by that clause's wording. But it will also proceed on the basis of its understandings of general conflict principles (such as the lex specialis rule), or of presumptions in favour of or against a specific interpretation. Even where the norm in question is treaty-specific, a tribunal interpreting it thus will operate on the basis of general concepts. It appears that inconsistent decisions such as the *SGS* or *Lauder* cases simply did not turn on the specific wording of a given treaty, but were decided because tribunals approached these general questions differently.[66] To sum up on this point, despite the various arguments advanced by commentators, there is indeed a problem of inconsistency. This leads to the final question: Could an appellate body solve it?

3. Could an Appellate Body Solve the Problem?

At first sight, the answer plainly to this question is in the affirmative. Within many national legal systems, authoritative pronouncements by highest courts often put an end to long-term disputes, between district or regional courts. Similarly, the WTO Appellate Body is widely credited for having rendered dispute settlement in world trade law coherent and predictable. Why, then, to give but one example, should an appellate investment court not authoritatively, determine the proper interpretation of regularly-worded umbrella clauses? While that prospect is indeed appealing, one major problem remains: It must also be stressed that not all appellate systems are likely to render investment law more consistent. Instead, the consistency argument presupposes that the future appeals facility would be established in a particular way. Three specific features can be distinguished.

- First, as a minimum requirement, there would have to be one single appeals facility.[67] As has been noted above, it would be relatively easy for States to agree on a right to appeal under specific treaties. It has also been shown that these treaty-specific appeals could either be handled by one single appellate structure, or by different appellate structures established under the different treaties. If States agreed on various appellate structures for different treaties (such as BITs or multilateral investment treaties), these could admittedly exercise a sane influence on investment law *under that treaty.* With respect to some, widely applicable treaties, this might already be some advantage – for example, a NAFTA appellate investment facility might consolidate the inconsistent case-law on NAFTA standards of protection. But from an ICSID perspective, this would be rather counter-productive, as other appellate structures (for example, an appellate body established under the Energy Charter Treaty) could reach different re-

66 *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1563 *et seq.* and 1569 *et seq.*
67 Cf. also *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 8 (10).

sults.[68] This would add, rather than reduce, uncertainty, and would further fragment dispute settlement under the ICSID system.[69]

- Second, the consistency argument depends on the comprehensiveness of the would-be appellate system. It would not be sufficient for different investment treaties to envisage recourse to one and the same single appellate institution. Rather, that appellate institution would be best suited to bring about consistency if it was competent to hear appeals in *all* investment disputes. The reason for this is that, given the decentralised character of dispute settlement, appellate decisions would first and foremost have to influence subsequent arbitral awards. On that assumption, an appellate decision determining the meaning of an umbrella clause would have good chances of being followed by subsequent tribunals if these tribunals' awards were also subject to appellate review (by the same appellate institution that had rendered the first appeals decision). The situation might be different if the subsequent first-level arbitral tribunal called upon to interpret and apply the umbrella clause would not be part of the ICSID appeals system. Of course, the first-level tribunal could still be persuaded to follow the previous appellate decision – just as presently, ICSID tribunals can of course opt to follow previous arbitral decisions. However, it seems that only the possibility of appeal would really increase the likelihood of consistent decisions. In short, in order to bring about consistency, and to modify the present situation (in which tribunals *can* opt for consistency, but at times do not seem to do so), the future appellate structure would have to be comprehensive, or at least competent to hear appeals in a large majority of cases. In contrast, systems of piecemeal appeal would probably produce no more than piecemeal consistency.
- Third, the consistency argument also favours a specific organisational set-up of the future appeals facility. Even if there was a single and comprehensive appellate structure, the appellate institution would probably have to be organised as standing permanent body, or at least composed of members drawn from a rela-

68 The point was made very clearly by *Sheppard* and *Warner* (Editorial Note, Transnational Dispute Management 2/2005, 3 [4]): "If appellate bodies are established on a particular rather than universal basis, this runs the risk of undermining the reasons for establishing such a system in the first place." See also *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 8 (10): " I would suggest that if we wind up with multiple appellate bodies, as opposed to a single appellate body, that much of the reason underlying the need for an appellate body is going to be undermined."

69 See also the ICSID Discussion Paper (footnote 1), para. 23: "If, however, multiple appeal mechanisms are to be established, ICSID might best abstain from pursuing the creation of an Appeals Facility as it might otherwise only add to the number of appeal mechanisms."

tively small roster of permanent members.[70] Once more, the matter admittedly involves a certain degree of speculation. Yet, experience with the present ICSID dispute settlement system suggests that consistency requires a certain degree of personal and institutional continuity. The point may be illustrated by reference to annulment applications under Article 52 ICSID Convention. At present, annulment is – in the terminology used here – based on a single and comprehensive system, as all annulment applications are handled by ICSID annulment committees governed by Article 52, and as all awards are in principle subject to annulment.[71] Still, a quick glance at cases such as *Klöckner, Vivendi* or *MINE* shows how differently annulment committees have interpreted their task.[72] Much suggests that this difference is largely due to the lack of personal continuity. Had there been, under Article 52, a standing annulment institution, it seems safe to predict that there would not have been such vast differences between the different generations of annulment decisions. Conversely, the relative consistency of WTO Appellate Body jurisprudence (or of ICJ or ITLOS jurisprudence, to take examples of judicial institutions typically acting as first-level courts) is in large measure due to the personal and institutional continuity of the respective bodies. The lesson to be drawn from this experience is that if indeed, ICSID appellate jurisprudence should bring about consistency, it should best be conferred upon a permanent, standing institution composed of a small number of arbitrators.[73]

4. Interim Assessment

The preceding considerations significantly affect the force of the consistency argument. Following the line of argument set out above, one might say that a plurality of appellate facilities would probably do more harm than good. A piecemeal appellate institution with non-comprehensive competence would probably do little harm, but not much good either. (Although of course much may be a question of degree: 90% appealibility would be non-comprehensive in theory, but would go quite some way in fostering consistency, while 20% would not.) Lastly, in order to bring about con-

70 Not surprisingly, such an approach (which clearly follows Article 17:3 of the WTO DSU) is indeed suggested in the ICSID Discussion Paper (note 1): see Annex, para 5: "Such a set of ICSID Appeals Facility Rules could provide for the establishment of an Appeals Panel composed of 15 persons elected by the Administrative Council of ICSID on the nomination of the Secretary-General of the Centre. The terms of the Panel members would be staggered. Eight of the first 15 would serve for three years; all others would be elected for six-year terms. Each member would be from a different country. They would all have to be persons of recognized authority, with demonstrated expertise in law, international investment and investment treaties."

71 See *supra*, section B.I.

72 *Ibid*.

73 *Legum*, Visualizing an Appellate System, Transnational Dispute Management 2/2005, 64 (66).

sistency, the appeals facility would probably have to have very few members, and function on a permanent basis. These considerations are not aimed at discarding the consistency argument altogether. As a matter of principle, it remains valid, and strongly militates in favour of reforming the present system. However, it has also been shown that in order to foster consistency, the ICSID system would have to opt for a quite particular form of appeals structure, and one that is not likely to be easily agreed on. Lastly, the fragmentation of substantive investment law means that even an appeals institution fulfilling these requirements would not solve the problem of inconsistency altogether. In short, the consistency argument is much qualified by both practical considerations and the specific features of investment law.

II. An Appellate System Would Be More Likely to Produce Correct Decisions

The hope for consistency is one argument in favour of reforming the present ICSID system. But there is a more basic promise of introducing a second level of dispute settlement. Having two levels of dispute settlement could enhance the prospects of correct decisions – one might call this the ‘accuracy' or 'correctness argument'. Its idea is that an investment appeals court is more likely to 'get it right' than ICSID panels of arbitrators at present. This in turn might be more important to investors or States than the time and cost spent during litigation – as *V.V. Veeder's* observation suggests:

"Of course, for the investor or the state, the final successful arbitration award is always an undisguised blessing. […] But, for the unsuccessful investor, an adverse final award is obviously adversely final and the result or reasoning of the award can act as a defect of precedent for other investors facing the same issues. Thus finality may be less desirable for the investor and investment arbitration than getting the answer right."[74]

It is difficult to take issue with the proposition that arbitral tribunals should render correct decisions, and therefore proposals aiming at correct decisions should be welcomed. But would an appellate system really increase that possibility? At a general level, the answer is probably yes. The investment appellate body could focus on the issues that divide the parties, and it would have the benefit of having before it one fully-reasoned decision. On the other hand, there is of course no guarantee. But maybe more important than these general considerations is whether the ICSID system needs an appellate level to have bad decisions corrected. This question of course can hardly be answered comprehensively – since a comprehensive answer would presuppose an exhaustive assessment of ICSID jurisprudence. Yet, it may be helpful to approach it from the perspective of ICSID's clients. Does their conduct provide evidence for a general dissatisfaction with the present system based on one level of dispute settlement? It is submitted that the answer to this question is "no". Of course,

74 Transnational Dispute Management 2/2005, 6.

the decision of some States to draft investment treaties envisaging an appellate structure is an important factor. However, it is a factor that has to be put into perspective. From a more general angle, this State practice is probably less impressive than it seems (or than the ICSID Secretariat suggested in its Discussion Paper). It has to be contrasted to a number of other factors which are clear evidence of trust placed in the ICSID system *in its present form.* These other factors include

- the still increasing number of States ratifying the Convention and concluding investment treaties with ICSID jurisdictional clauses;
- the willingness of investors to bring ICSID claims;
- the readiness of States to comply with ICSID awards;

These factors are not intended to suggest that everything was perfect. However, they suggest that in the view of most parties, the present system with one level of dispute settlement can still be trusted. As has been shown,[75] it is a system that was designed after careful deliberation, a system that had to strike a balance between the need for correct decisions, and the interests of finality, i.e. time, cost and trust in panellists. On balance, the preceding considerations do not show any sustained and wide-spread desire among ICSID participants to move away from that system, towards an appellate structure. Proposals for a reform thus rest on abstract propositions about the relative advantages of appeals structures generally, which cannot be simply applied to the ICSID system. With respect to investment law, it seems that the drafters' decision to place trust in a single level of arbitration, and to emphasise the need for a speedy resolution of disputes, still holds true today. As a consequence, the 'accuracy argument' is not really convincing.

III. An Appellate System Would Increase the Authority of ICSID Awards

Even if it is not strictly called for in order to bring about consistency, or to eliminate errors, setting up an appeals facility may have other positive effects. According to some, it might increase the authority of investment awards. For example, *Audley Sheppard* and *Hugo Warner*, noting the limited legitimacy of investment arbitration, argued that "the presence of an appellate mechanism" – which they held "should be as authoritative as possible" – "may partially solve this problem".[76] Few of course would dispute that investment awards lacking authority are problematic. In this respect, the basic rationale underlying the 'authority argument' seems appealing. Still, it is another question whether the introduction of an appeals facility would truly enhance the authority of investment awards. In this respect, it is necessary to distinguish between ICSID Convention awards on the one hand, and Additional Facility awards on the other.

75 *Supra*, section II.
76 *Sheppard/Warner* (footnote 68), Transnational Dispute Management 2/2005, 4.

1. ICSID Convention Awards

ICSID Convention awards could gain in authority because an appellate body rendering them might enjoy a higher degree of eminence than first-level tribunals. This would not necessarily be the case, but would not be unlikely if the appellate body was set up as a permanent institution composed of highly-respected lawyers, and if its jurisprudence over time earned the respect of the investment community. Experience with WTO law but also with national legal systems indeed suggests that standing higher-level judicial bodies over time can acquire a certain status as institutions, which in turn increases the authority of their pronouncements.[77] The same would not be unlikely to happen in investment arbitration, if one particular form of appellate institution (namely a standing body) was created. This standing appellate body could over time gain an institutional respect that *ad hoc* panels of arbitrators could not acquire. Seen from this perspective, the creation of an appeals facility might have a positive effect on the authority of investment awards, including awards rendered under the ICSID Convention. Just as with respect to the accuracy argument, the real question however is whether this potential would justify a major overhaul of the presently decentralised system. The answer to this question does not only depend on the reform's potential effects, but on whether it is necessary. It must therefore be asked whether at present, without an appeals facility, investment awards rendered under the ICSID Convention lack the required authority. This in turn depends on legal provisions determining the status of awards, as well as on compliance in practice.

As far as legal provisions are concerned, awards leave little to be desired. Article 53 of the Convention declares them to be binding, while Article 54 equates them to decisions of highest national courts. As has been noted already, the Convention deliberately rules out any possibility of national court review; instead it provides an exceptionally strong enforcement mechanism.[78] When looking at the letter of the law, ICSID Convention awards thus could hardly be more authoritative than they already are at present.

Ultimately, however, an award's authority depends on whether it is complied with in practice. In this respect, investment awards also perform rather well. Of course, States have often expressed dismay when required to pay large sums of damages; some have also voiced concern of a more general nature, and have threatened to leave the system of investment law altogether.[79] These warnings should not be ignored. But they also have to be put in perspective. From a broader angle, it seems that States' criticism of the system has remained exceptional, and has not been fol-

77 See already *supra*, section D.I.4.

78 *Supra*, section B.I.

79 See notably Argentina's threats to re-admit a review of ICSID awards by national courts, and to re-introduce the Calvo and Drago clauses: cf. *Alfaro*, ICSID Arbitration and BITs Challenged by the Argentine Government and its Supreme Court, Oil Gas and Energy Law (OGEL) Vol. 2, Issue 4, 2004, available on the internet: http://www.gasandoil.com/ogel.

lowed up by concrete actions. Certainly when compared to other forms of international dispute settlement, compliance with investment awards remains largely unproblematic, despite the high stakes involved. Paraphrasing a famous dictum about compliance with international law generally, it seems fair to say that 'almost all States comply with almost all investment awards almost all the time'.[80] In fact, notwithstanding a few problematic cases of enforcement,[81] all ICSID Convention award have so far been complied with; there is thus no investment law equivalent to famous inter-State instances of non-compliance such as the ICJ *Nicaragua* decision.[82] Also, investment awards have usually[83] been complied with promptly. Again, compared to other international bodies' track record, there is no equivalent to the decades it took Albania to accept the ICJ's *Corfu Channel* decision,[84] or Turkey's year-long refusal to pay Mrs. *Loizidou*.[85]

The preceding paragraph should not be taken as a plea for complacency. Of course, even systems with good compliance records can break down, and lose their authority. What is important to note is that despite repeated warnings, and notwithstanding the high stakes involved, the ICSID system *is* a system with a good compliance record. Legally, the Washington Convention imbues awards with a high degree of authority. In practice, States have complied with awards. On that basis, it does not seem necessary to introduce an appeals system in order to increase the authority of ICSID Convention awards.

2. Additional Facility Awards

As far as Additional Facility awards are concerned, the different considerations set out in the last section equally apply. In particular, it is worth pointing out that despite the possibility of national court review, Additional Facility awards also have a good compliance record so far. Still, the aftermath of the *Metalclad* award[86] shows the potential for conflict. Figuratively speaking, the British Columbia Supreme Court decision[87] may have been a shot over the bow, signalling national courts'

80 Cf. *Henkin*, How Nations Behave (2nd edn., New York, 1979), 47: "Almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time."

81 Namely the *Benvenuti*, *SOABI*, and *LETCO* cases. On compliance in the former two see the information provided in *Schreuer*, The ICSID Convention (footnote 8), Article 54, MN 50-60.

82 ICJ Reports 1986, 14.

83 For exceptions, see notably the cases referred to in footnote 81.

84 ICJ Reports 1949, 4.

85 The various awards in the case are available on the internet: http://cmiskp.echr.coe.int/tkp197/view.asp?item=3&portal=hbkm&action=html&highlight=loizidou&sessionid=6636633&skin=hudoc-en.

86 *Supra*, footnote 54.

87 Decision of 2 May 2001, [2001] SCBC 664, available on the internet: http://www.investmentclaims.com/oa1.html.

unwillingness simply to accept investment awards at face value. Of course, *Metalclad* itself was controversial, and it is worth pointing out that the shot went over the bow rather than hitting the ship. However, the proceedings show that investment awards rendered outside the ICSID Convention are vulnerable, and do not enjoy the protection, or authority, which Arts. 53-54 confer upon Convention awards.

According to some, the establishment of an appeals mechanism might provide an opportunity to remedy this problem. In the words of *Daniel Price*, "if we are going to have an appellate mechanism then it […] has to displace completely the role of national courts presently exercised under the New York convention".[88] In other words, Additional Facility appellate awards would be as immune from national court review as ICSID Convention awards. It is not quite clear how that proposal should be implemented – probably best by including a waiver clause in the relevant jurisdiction-conferring instruments. But it is clear that it would enhance the status of investment arbitration and remedy one of the weaknesses of Additional Facility awards compared to awards rendered under the ICSID Convention. In that respect, one might indeed be tempted to say that the creation of an appeals facility could increase the authority of investment awards rendered outside the ICSID Convention. However, it should also be pointed out that this would not be an automatic consequence, but depend on the willingness of States to take the extra step of "elevating" Additional Facility awards, as far as their immunity from national court review is concerned, to the level of ICSID Convention decisions. Whether States are willing to take that step, and whether they would be willing to do so in each and every treaty envisaging an appellate investment decision, is another matter.

3. Interim Assessment

To sum up, the 'authority argument' provides limited support for the establishment of an ICSID appeals facility. A permanent investment appellate institution, possibly modelled along the lines of the WTO Appellate Body, might gain an institutional prestige increasing the authority of its decisions. With respect to Additional Facility awards, States might also be willing to sacrifice national court review of such appellate awards. Both factors are speculative though: States need not necessarily recognise the higher status of appeals decisions, and institutional prestige is not gained lightly. In any event, investment appeals in practice do not really suffer from serious problems of authority, as compliance with them is very good. Also, at least with respect to awards rendered under the ICSID Convention, it is difficult to imagine how awards, as a matter of law, could be more authoritative. Lastly, one should not forget one potential drawback of appeals systems, which may be seen as the 'authority argument' turned on its head. As has been noted, while potentially increasing the

88 *Price*, US Trade Promotion Legislation, Transnational Dispute Management 2/2005, 48; similarly *Legum* (footnote 73), Transnational Dispute Management 2/2005, 64.

authority of some decisions, a move towards a two-tiered system of dispute settlement risks undermining the authority of the first level decision.[89] Even if a two-level process of dispute settlement eventually produced decisions that were more authoritative then the ones presently rendered, this increase in authority would have to be measured against a loss of authority of the first level awards. On balance, therefore, the 'authority argument' provides only rather ambiguous support for the creation of an ICSID appellate structure.

IV. Interim Conclusions

The preceding sections have examined a rather heterogeneous range of arguments put forward to support the establishment of an ICSID appeals facility. They have shown that a reasonably good case for introducing an appeals structure can be made. Primarily, this case rests on what has been labelled the 'consistency argument', i.e. the hope that an appeals facility would render investment law more coherent, and would put an end to the worrying series of inconsistent decisions by ICSID and other investment tribunals. In contrast, other arguments allegedly supporting the establishment of an appellate structure are of lesser value. In particular, it is a matter for speculation whether a two-tiered system of dispute settlement would produce better, or more authoritative decisions. In any event, judging from the conduct of ICSID participants, there do not really seem to be serious problems of authority or accuracy within the present system.

Whether this mixed record is sufficient to overcome the various drawbacks of a reform may be a matter of perspective – depending on which the glass may be considered half-full or half-empty. As has been shown, the drawbacks of a reform (some certain, some speculative) weigh rather heavily: not so much because of abstract concepts such as finality, but because the possibility of appeals would make investment proceedings more expensive, would prolong the period of uncertainty between the application and the eventual decisions and could de-value the authority of first-level awards. Perhaps most importantly, anyone considering the opposing arguments should bear in mind that in order to achieve the desired results, one would have to opt for a specific form of appeals facility: for the various reasons explored above, a meaningful reform of the system would have to seek to establish a single permanent institution with comprehensive competence. In contrast, treaty-specific appeals jurisdictions, possibly even organised in multiple fora, would probably (at least from an ICSID institutional point of view) increase rather than alleviate problems.

In the light of these considerations, the better arguments suggest that the glass is half-empty. The case for establishing an appeals facility is certainly not compelling. Given the difficulties of a reform, and the range of ensuing consequential problems

89 Section C.II.

which the present paper has not even touched upon, one should probably not risk paralysing a still-functioning system by seriously engaging in a far-reaching institutional reform. On balance, the benefits seem too speculative, the institutional costs too high, and the chances of success too slim.

D. Alternatives

So far, this paper has focused on the rather drastic reform proposals put forward by the ICISD Secretariat in its October 2004 Discussion Paper. The preceding section suggests that even with more time and a more methodical discussion, that drastic reform should not be pursued. Admittedly, the cautious approach thus advocated may also cause problems – experience suggests that often, postponing reforms is as dangerous as an over-ambitious reform gone awry. To avoid that problem, a number of alternatives to an appellate structure will be briefly examined in the following. These alternatives are all aimed at remedying the most problematic feature of ICSID dispute settlement, namely that of inconsistent awards.

I. Critical Debate of Inconsistent Awards

The most obvious of the various alternatives examined in the following is a plea for a critical peer review of inconsistent awards. This review should be aimed at highlighting the risks of inconsistent awards; it should encourage tribunals to avoid outright contradictions in their respective reasoning, or at least to explain contradictory approaches with reference to the specificities of the case before them. While obvious, these proposals may indeed be helpful. Experience with inter-State dispute settlement suggests that a professional debate about the risks of fragmenting international law through inconsistent decisions does exercise a moderating influence on tribunals. To come back to the public international law example referred to earlier, it bears underlining that since the beginning of the critical debate about inconsistent decisions (triggered by the *'Tadic-Nicaragua* conflict'), there do not seem to have been any further instances of serious conflicts between different international tribunals. Of course, the reasons for this healthy development are difficult to re-establish, but it does not seem to be far-fetched to suggest that the existence of a critical debate may have been a force for the good. Based on that experience, one might hope that "transparency, publication and informed and professional peer discussion"[90] would reduce the number of inconsistent investment awards. In that respect, the on-going discussion, among ICSID officials, ICSID clients, arbitrators, counsel and academics, about the coherence of investment law, as well as the general trend towards a more rigorous scrutiny of ICSID decisions may have a sane influence on future

90 *Wälde* (footnote 26), Transnational Dispute Management 2/2005, 77.

ICSID panels.[91] They might be part of an evolution of investment law, a process eventually leading to "the development of a common legal opinion of *jurisprudence constante,* to resolve the difficult legal questions [dividing different arbitral tribunals]".[92]

II. Consolidating Cases

As noted above, inconsistent decisions may simply be a consequence of decentralised, *ad hoc* dispute settlement by different panels of arbitrators. Not surprisingly, then, one way of avoiding inconsistent decisions may be to consolidate cases. Admittedly, consolidation has a number of drawbacks. The most obvious is that it only becomes an option if two or more proceedings concern the same subject-matter.[93] Yet, the Argentine experience suggest that this does happen. At least for some types of conflicts, consolidation might be a way out of the dilemma. In fact, it would seem to be a rather attractive option.[94] It is an option already available under the present system, which does not prevent parties from joining proceedings and appearing as parties in the same interest. Alternatively, parties remain free to consolidate cases in an informal way, by agreeing to nominate the same arbitrators – which is what happened in some of the recent proceedings concerning the Argentine's privatisation of the gas industry.[95] If this is done, formal or informal consolidation would seem to provide very effective remedies against inconsistent decisions. As a rule, they would also be likely to save money and time. Of course, given its drawbacks, it will not solve the problem of inconsistent decisions altogether, but at least it may alleviate it to some extent, and thus prove a helpful alternative.

91 *Wälde*, *ibid.*; similarly *Gill* (footnote 46), Transnational Dispute Management 2/2005, 13.

92 Cf. *SGS-Phllipines* (footnote 45), para. 97.

93 For an interpretation of what is meant by the general requirement of "same subject-matter" see *Crivellaro*, Consolidation of Arbitral and Court Proceedings in Investment Disputes, 4 Law and Practice of International Courts and Tribunals (2005), 371 (394 *et seq.*).

94 See also *Blackaby*, Testing the Procedural Limits of the Treaty System: The Argentinean Experience, Transnational Dispute Management 2/2005, 19, and the brief observation by *Wälde* (footnote 26), Transnational Dispute Management 2/2005, 76.

95 Namely *Camuzzi International S.A. v. Argentine Republic*, Case No. ARB/01/3, and *Sempra Energy International v. Argentine Republic*, Case No. ARB/02/16. In both cases, the tribunal was composed of *Francisco Orrego Vicuna*, *Marc Lalonde* and *Sandra Morelli Rico*. The concurrent decisions on objections to jurisdiction are available on the internet: http://www.worldbank.org/icsid/cases/awards.htm. For brief information on other informally consolidated cases see *Blackaby* (footnote 96), Transnational Dispute Management 2/2005, 18-19.

By the same token, States might consider formulating ICSID disputes as inter-State disputes and submit them to the United Nations "principal judicial organ"[96], the International Court of Justice (ICJ). This is an option which so far has not been pursued, but which is explicitly foreseen in Article 64 of the ICSID Convention. Just as consolidating cases, turning to the ICJ does not offer a proper substitute for an appeals system. In fact, Article 64 only establishes the Court's jurisdiction over inter-State disputes "concerning the interpretation or application of th[e] [ICSID] Convention". The drafting history clearly shows that the provision was not to be used to introduce a form of appeal to the ICJ. What is more, according to Article 34 of the ICJ Statute, disputes would have to be formulated as disputes between two States. It would thus require some creative legal argument to present disputes about specific investment treaties (such as the precise interpretation of BIT standards) as "ICSID disputes" coming within the ICJ's jurisdiction.

Within those limits however, it is submitted that Article 64 of the Convention could play a helpful role, and deserves more attention than it is usually given. There are good reasons to assume that ICJ judgments on matters of investment law are more likely to be generally accepted than decisions by three member *ad hoc* tribunals or committees. This first of all has to do with the Court's standing: the "World Court" is a venerable institution composed of 15 permanent members representing "the main forms of civilization and the principal legal systems of the world."[97] Its special status is reflected in the frequent references, in ICSID awards, to ICJ judgments,[98] but also in the broad acceptance of important ICJ decisions on issues such as diplomatic protection or the nationality of corporations. Contrary to *ad hoc* arbitral bodies, the Court thus possesses a considerable institutional authority, which would imbue its pronouncements on investment law matters with a considerable authority. The solemn atmosphere and length of ICJ proceedings might add to this; both would mean that an eventual decision would be rendered only after detailed argument and would be well considered. In short, there might be some virtue in using the ICJ to clarify particularly important matters of investment law.

96 Cf. Art. 92 UN Charter.

97 Cf. Article 9 ICJ Statute.

98 A particularly prominent example is the jurisdictional award in *CMS*, which extensively discusses the ICJ's *Gabcikovo Nagymaros case*, and also refers to the *Nicaragua* and *ELSI cases*: *CMS Gas Transmission Company v. Argentina*, Decision on Jurisdiction of 17 July 2003, paras. 309, 313, 330, 339, 371, 372.

IV. A Reference Procedure Along the Lines of Article 234 TEC

Finally, a reference procedure along the lines of Article 234 TEC[99] might be yet another alternative to an appeals facility.[100] Under that provision, national courts can refer certain matters of law to the ECJ for decision.[101] When answering an Art. 234 reference, the ECJ is not acting as an appellate court, but simply ruling on a point of EC law. It remains for the national court to use this information to decide the case. Still, experience within Europe suggests that the reference procedure is one of the ECJ's most powerful tools in ensuring the uniform application of EC and EU law. Of course, this experience cannot simply be used as a blueprint for investment arbitration. Unlike under Article 234 TEC, references would have to be made not by national courts, but by arbitral tribunals. In many respects, the institution competent to decide on references would face problems similar to those of an appellate institution: for example, one would have to agree on the scope of review, or on the types of questions that could be referred to it, and on its composition. In addition, one would have to decide which parts of its rulings should bind normal ICSID arbitral tribunals, whether this binding force should also extend to subsequent cases, and whether ICSID tribunals could be under an obligation to make reference. In short, the problems of implementation would be enormous. Still, introducing a reference procedure would have one decisive advantage over plans to establish an appeals system: it would not conflict with Art. 53 of the ICSID Convention. Even with a reference system, ICSID awards (following a reference decision) would not be "subject to any appeal". There would thus be no need for an amendment of the ICSID Convention; in contrast, the reference system could be established through an amendment of the ICSID Rules.

99 In its entirety, the provision runs as follows: "The [European] Court of Justice shall have jurisdiction to give preliminary rulings concerning:
(a) the interpretation of this Treaty;
(b) the validity and interpretation of acts of the institutions of the Community and of the ECB;
(c) the interpretation of the statutes of bodies established by an act of the Council, where those statutes so provide.
Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the [European] Court of Justice to give a ruling thereon. Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the [European] Court of Justice."

100 For brief comments in that regard see e.g. *Kaufmann-Kohler*, Annulment of ICSID Awards in Contract and Treaty Arbitrations: Are there Differences?, in: *Gaillard/Banifatemi* (footnote 8), 189 (221).

101 For details on Article 234 see e.g. *Tridimas*, Knocking on Heaven's Door: Fragmentation, Efficiency and Defiance in the Preliminary Reference Procedure, Common Market Law Review 40/1 (2003), 9-50; *Dauses*, Das Vorabentscheidungsverfahren nach Artikel 177 EG-Vertrag (2nd edn., München, 1995).

Compared to the other options discussed in the present section, an ICSID reference procedure is certainly the most ambitious alternative to an appeals system. Unlike ICJ references or the consolidation of cases, it would require an amendment of ICSID's institutional set-up. However, its establishment would be less cumbersome than that of an appeals system proper.

E. Concluding Observations

The present paper suggests that there are no compelling reasons to move towards an investment appellate structure. The drafters' decision to set up ICSID as a single-level system of dispute settlement remains plausible today. This system, based on decentralised dispute resolution by *ad hoc* tribunals, has very few instruments to prevent inconsistent awards, which is a serious problem. However, this problem should not be addressed by establishing an appellate structure. Instead, there may be virtue in simply highlighting the risk of inconsistent decisions, or to make use of two existing alternatives: consolidating cases, or seeking ICJ decisions. If this proves insufficient, and if a major reform of the present system becomes unavoidable, then it would be preferable to opt for an ICSID reference procedure along the lines of Article 234 TEC.

A Development Perspective to the Introduction of an Appellate Process in International Investment Arbitration

Comment by *Asif H. Qureshi*[*]

I am very grateful to the organisers of the conference for having given me the opportunity to comment on Dr *Tams's* paper. My sincere thanks for the warm hospitality I received in Frankfurt.

I am very impressed by Dr *Tam*'s paper - which excels in being very informed, very considered but most of all very measured. Generally, I would make three observations.

First, it seems to me that deconstructionists would have much to say about proposals for reform in the international investment dispute settlement system, given that it is largely set against a normative framework that is bilateral, disorganised and non-multilateral. Is it really possible to meaningfully evaluate the arguments for and the obstacles in setting up an appellate facility in the investment sphere, with the objective of providing normative coherence, in circumstances where the multilateral consensus on substantive matters is not very evident. Does this institutional debate not partake of our concerns and preferences with respect to the normative framework of investment? Indeed, is the suggestion for an appellate facility at a multilateral level not an attempt to force an issue on the international agenda - one which has not received the endorsement for being negotiated by a significant constituency concerned with international investment law? In recent history this lack of endorsement has happened twice, first in the context of the negotiations for a Multilateral Investment Agreement (MIA) under the auspices of the OECD, and then under the Doha Agenda within the WTO.

Second, in my opinion it is not possible to engage in constructing dispute settlement mechanisms - without reference to the nature of the underlying normative structure. The case for an appellate facility must be set against the objectives and purposes of the provision of dispute settlement *in the international investment sphere*. It is not possible to de-link institutional building from its substantive sphere and its underpinnings. The objects and purposes of the international investment system along with its normative framework inform the institutions that govern and serve it. The objectives of investment are not confined to the investors' concerns alone. Thus, 'consistency, accuracy and authority' in dispute settlement may be significant reasons for institutional reform - but there are other concerns which may

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seek to trump these considerations - for example human rights, environment and of course the development objectives of the host State.

Third, there is no doubt in my mind that there is a development perspective in the establishment of an appellate process in the investment sphere. This involves ensuring inter alia that:

- the review process facilitates the development objective;
- that the review process reduces or alleviates the burdens that accompany investment liberalisation through the interpretative process;
- that there exist independent, fair and transparent processes in the appellate structure, through for example ensuring effective participation of developing/host countries in the appellate process;
- that the power of multinational corporations is not unduly strengthened through the abusive use of an appellate process;
- that the national legislative 'policy space' developing countries need for their development objectives is not undermined through the introduction of an appellate process;
- that the appellate system does not lead to the multilateralization of bilaterally negotiated agreements; and thereby compromise the flexibility afforded by a bilateral system along with the collective decision of developing countries not to engage in a multilateral system that is not development friendly.

More specifically with reference to some of the main points made in Dr *Tam'*s paper, the following questions are posed. First, is the justification for an appellate system on the basis of 'consistency and coherence' in judicial outcomes not really an argument for moulding a particular kind of 'consistency and coherence' into the disorganised international investment system - given that interpretation in an appellate process is a form of legislation? Is the objection to 'inconsistency' not really a call for normative uniformity? Second, should disparate investment norms necessarily be interpreted identically on the basis of equality, fairness, predictably and reliability? Third, if investment involves and is about ultimately ensuring development - should development not be the overriding consideration in the process of interpretation? Should there not be a strive consistently at better facilitating the 'development objective' and better decisions all round, rather than pursuing a fetish for identity of interpretation? Fourth, will a non-ringed fenced appellate system, set against a disorganised bilateral investment normative framework, not add to uncertainty and complexity - given that the beneficiaries of and parties to bilateral agreements will not be clear as to how ultimately their rights and obligations will be 'coherently and consistently' interpreted, not to mention the added complexity in interpretation arising from such a system? Finally, will an appellate system not lead to further investor bias, by augmenting the capacity of multilateral companies to pursue an appeal?

In conclusion I would agree with Dr *Tams'*s negative assessment of the 'consistency' basis for an appellate system but for different reasons. I would not put it on such a high pedestal as other objectives - particularly the development objective. From a development perspective a treaty specific appeal system is favoured. A principal concern about the efforts for introducing a non-ring fenced appellate system in

the investment sphere is that it seeks to add to the coherence and development of international investment law through a somewhat non-transparent route. Further, the need to inject the development dimension in any proposed appellate system is important. A development friendly appellate system requires in particular a focus on its apparatus of interpretation; on participatory rights and technical assistance.

Inconsistent ICSID Awards – Is There a Need for an Appellate Structure?

Comment by *Richard H. Kreindler*[*]

It is a great pleasure to comment briefly on the excellent presentation and conference paper provided by Dr. *Tams*, entitled "Is There a Need for an ICSID Appellate Structure?" Dr. *Tams* has sought to tackle a thorny question which is of increasing relevance both as a scientific inquiry and as a matter of practical relevance. It affects the everyday life of international investment-related contracts, dispute resolution provisions and subsequent arbitrations.

My brief comments and observations use Dr. *Tams*' paper as a point of departure. They admittedly somewhat transcend the specific content of his own paper, and are organized into four areas of inquiry as follows:

- *First,* Is there a trend in favor of an appellate mechanism in this area?
- *Second,* How may this question be addressed in the ICSID Convention[1] context versus bilateral and multilateral treaty contexts?
- *Third,* What arguments exist for and against an appellate mechanism in this area?
- *Fourth,* What may be said of Dr. *Tams*' specific proposal respecting "reference 0proceedings" and could one contemplate analogous application of Article 1131(2) of the NAFTA[2]?

A. Trend in Favor of Appellate Mechanism

The increase in number and size of investment-related and particularly ICSID Convention-based arbitrations in the last ten and particularly five years – some would term it an onslaught – has led various observers to question whether some form of appellate mechanism may now be called for. These observers include consumers of arbitration, professors, practitioners and arbitrators, and some wearing more than one of these hats simultaneously. The very transparency of many investment-related arbitrations, especially those under the ICSID Convention, has given rise to dis-

* *Richard H. Kreindler,* Attorney Shearman & Sterling LLP, Frankfurt. The original presentation style has intentionally been substantially preserved.

1 Available, *inter alia*, at http://www.worldbank.org/icsid/basicdoc/CRR_English-final.pdf.

2 Available, *inter alia*, at http://www.investmentclaims.com/instruments/NAFTA%20Text%20%20Excerpts.pdf.

crepancies or disconnects, or perceived discrepancies and disconnects. Some have seen these as providing justification for some form of appellate review at a supranational level.

Whether a true trend in this respect has been emerging is difficult to say. Trends with respect to ICSID-related arbitration are sometimes measured by comments in doctrine, sometimes by holdings and dicta in awards, sometimes by observations at conferences and increasingly by web-based exchanges. The sum total of the foregoing does not necessarily suggest, in my mind, a trend in favor of an appellate mechanism.

What it does suggest is that increasing disquiet is emerging in some circles over the discrepancies and disconnects, or perceived discrepancies and disconnects, that may have emerged from one award to the next. These relate to such fundamental issues as the "fair and equitable treatment" standard and other public international law-based measurements which play a role in investment-related contracts, claims and disputes.[3] On another level, it might be claimed that such a trend is in fact already emerging, even at an official or semi-official level. One example of such a manifestation might be the October 2004 ICSID "Discussion Paper on Possible Improvements of the Framework for ICSID Arbitration" (October 22, 2004).[4]

If there is such a trend, is this trend correct? And even if it is not correct, is it irreversible?

Whether such a trend is "correct" cannot possibly be answered in a uniform manner. Indeed Dr. *Tams* himself does not presume to attach a blanket correctness or incorrectness to any such trend. If for no other reason, it is impossible and in any event ill-advised to consider such a trend to be the proper path. The reason is that the factors causing a perceived need for an appellate structure are diverse. They affect only some ICSID matters and not others. They are in part a sign of the times which may change over the next few years.

The supposed need for and lack of uniformity and harmonization which some would see as the justification for an appellate structure may, even if it did exist today, look quite different in five years, with the benefit of further jurisprudence and doctrinal development. And also for that reason, the trend should not be considered irreversible. The need seen by some for harmonization and supra-level control today may be looked at with different colored glasses in the next decade.

3 *See, e.g., Kreindler*, "Fair and Equitable Treatment – A Comparative International Law Approach," presented at the Harvard Law School Conference on "International Investment Law at a Crossroads," March 3, 2006, and *reprinted in* Transnational Dispute Management-TDM, Vol. 3, Issue 3, June 2006.

4 Available*, inter alia*, at http://www.asil.org/ilib/2004/10/ilib041030.htm#d1.

B. ICSID Convention versus Other BIT/MIT Contexts

The focus here is avowedly on ICSID arbitration (both contractual and non-contractual), and not on ICSID Additional Facility[5], NAFTA or other non-ICSID bilateral investment treaty (BIT) or multilateral investment treaty (MIT) bases. Indeed in the overflow of discussion that has emerged regarding the possible need for an appellate structure, it is sometimes neglected that certain of the phenomena which are being experienced in investment-related arbitration, whether for good or for ill, have little or nothing to do with ICSID Convention matters per se. Rather, they are rooted in specific, individually – and often idiosyncratically – drafted and interpreted BITs and MITs.

At the same time, discussion in isolation or ignorance of other investment-related arbitration would be misleading, illusory and counterproductive, so that the ICSID discussion is to a great extent a global discussion. Many, if not most, of the at least publicly accessible ICSID awards which have an influence on the emerging investment-related jurisprudence respecting such matters as expropriation, minimum standards and the like may also be seen as influential in non-ICSID based arbitrations and awards which address essentially the same issues. And in reverse, various non-ICSID based awards which have entered the public domain have been considered by ICSID Convention-based tribunals at least as having a certain precedential influence or weight.

C. Arguments for and against Appellate Mechanism

The arguments for and against an ICSID or supra-ICSID "appellate structure" are already well articulated, and to a great extent evenly balanced. They include the following:

I. First: Predictability

The rationale is that if all ICSID Convention awards were subject to a largely uniform standard and staffing of review and appeal, then both the underlying awards and any appellate decisions would ensure or at least promote greater predictability as to how recurring issues would or should be decided.

5 Available, *inter alia*, at http://www.worldbank.org/icsid/facility/facility.htm.

II. Second: Consistency

At first blush, consistency might be perceived to pose the same issues as predictability, and to be sure they are interrelated. At the same time, predictability is not necessarily a guarantee of consistency.

Consistency is not possible or desirable where a fact-driven analysis demands different results under different circumstances. On some levels, consistency is no more possible in public international law issues, including many affecting investment arbitration, than in commercial disputes, since the result is and should often be fact-dependent.

III. Third: Coherence

While arguably a subset of both predictability and consistency, coherence deserves its own standard and its own discussion, and is surely part of any debate about the need for an appellate structure.

It might be contended that incoherent awards are not likely to foster predictability or consistency. Yet the primary goal of a coherent award is that its reasoning and findings are understandable and defensible internally *inter se*, within the particular factual and legal framework of that dispute, its treaty or contract bases and the evidence adduced.

Thus on the one hand the coherence of an award, particularly in the transparent investment award context, may hinge on both the tenability of the conclusions under the particular factual and legal circumstances on the one hand, and on the tenability of the result vis à vis similarly situated prior awards. At the same time, an internally coherent award may appear to be incoherent when compared with other awards which are perceived as treating the same subject, particularly application or interpretation of the same legal principles or treaties.

IV. Fourth: Transparency

Transparency may be seen as affecting each of the factors already addressed above.

The more transparent or accessible an award or ruling, the more likely it is to attract the attention of judges, arbitrators, parties and counsel in simultaneously pending or future cases. In turn, the more likely it is to precipitate agreement or disagreement in subsequent awards or judgments. This is particularly so if the prior ruling breaks new ground, disagrees with a prior line of precedent or otherwise involves noteworthy participants and/or high stakes legally or commercially. An appellate structure, it is argued, may serve the goal of transparency by subjecting already transparent ICSID decisions to a further transparent scrutiny process.

This is of course assuming that transparency is accepted as a goal of arbitration or at least investment arbitration – which is by no means a uniformly held view.

V. Fifth: Accountability

Like predictability, accountability is somehow fused with the other factors discussed above. At the same time, accountability may be seen as portending greater control, greater circumspection and even greater mistrust of a process which, without some appellate review mechanism, would potentially go off on its own tangent.

Query whether such control and circumspection are possible or desirable. The same might be said of any appellate process whether in civil litigation or in arbitration generally. But it remains that appeal per se, as opposed to challenge or annulment on narrow and substantially procedural grounds, is largely considered anathema to arbitration. Annulment, on the other hand, including the ad hoc annulment scheme as practiced thus far in ICSID arbitration, is already seen as providing a certain measure of accountability.

Those who advocate a further and more elaborate ICSID appellate structure often point precisely to the ad hoc annulment scheme as being a partial failure, and as engendering not more accountability, but actually less. One reason for this view among those who hold it is that the ad hoc annulment scheme by design has been just that, ad hoc. Most conceptions of an ICSID appellate scheme, by contrast, foresee a finite and largely unchanging group of appellate judges or reviewers who, by virtue of their tenure over time, might serve the goal of accountability better than in an ad hoc process where the judges or reviewers are different from annulment to annulment.

This is all by way of presupposing that accountability in investment arbitration is desirable. While arbitrators should not be "unaccountable," it is not an entirely unanimous view that arbitrators chosen for an individual case with a specific seat, specific law and specific rules actually owe any "accountability" to anyone – except of course to the parties, the institution if any, and the courts at the seat in the context of the mandatory norms of due process, equal treatment and other sources of control typically considered to be synonymous with the grounds for opposition to enforcement found in Article V.1 and V.2 of the New York Convention.[6] In the case of a self-enforcing award which is not deemed to be subject to the New York Convention, then accountability is a matter between the arbitrators, the parties and the institution. Whether it extends further to issues of "creating good law" and the like is debatable.

6 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, art. V, available*, inter alia,* at http://www.uncitral .org/-pdf/english/texts/-arbitration/NY-conv/XXII_1_e.pdf.

VI. Sixth: Bias

Proponents and opponents of an appellate structure for ICSID often stray into the area of contending or denying that in the case of investor rights versus state rights, there is an inherent bias in favor of investor rights.

Query whether the ICSID (and non-ICSID) awards which have entered the public domain, particularly in the last five years, buttress the argument that there is a systemic, inherent or otherwise ineluctable bias in favor of investor protection. Surely the answer overall is largely no.

If that answer is correct, then a motivation for an appellate structure based on bias is misplaced. On the other hand, there is the perception that this is a moving target. That in the next several years more and more developing states will become defendants in ICSID and other investment arbitration. That more issues of bias may arise and that if only for perception reasons, an appellate structure applicable to all state parties alike may be politically expedient.

VII. Seventh: Challenges to Lis Pendens and Res Iudicata

The discussion surrounding an appellate structure also relates to concerns as to whether conflicts or perceived conflicts in legal holdings from one ICSID award to another relating to such issues as fair and equitable treatment, fork-in-the-road provisions, contract claims versus treaty claims, etc. are a threat to principles of *lis pendens* or *res judicata* known principally from the civil litigation field, and increasingly from international commercial arbitration.

This concern is in turn related to the notion that "forum shopping" or "treaty shopping" in the ICSID context may do violence to established notions of prior claims pending or precedent.[7] With the aid of an appellate structure, it is thought, disincentives to such shopping around might be created, thereby serving such other goals as predictability, consistency and accountability.

Whether this holds water is debatable, since the addition of an appellate stage to one arbitration does not clearly assist in preventing another arbitration (or litigation) with overlapping parties and issues from being commenced in parallel. Nor does an appellate structure for ICSID awards necessarily have any way of promoting precedential value of ICSID awards for non-ICSID investment arbitrations having different treaty bases.

7 *See, e.g., Kreindler*, "Arbitral Forum Shopping," in Parallel Arbitration Tribunals and Awards in International Arbitration, Dossiers 3 ICC Institute of World Business Law, 2005.

VIII. Eighth: Relative Adequacy of the Existing ICSID Annulment Mechanism

If the ICSID ad hoc annulment process is deemed to be working satisfactorily, then query why an additional appellate structure or an appellate structure in lieu of annulment would be called for.

Of course, annulment and appeal are not necessarily synonymous, and a two-tiered system would not be entirely unimaginable. On the other hand, proponents of an appellate structure largely have in mind a one-tier system in lieu of ad hoc annulment. For some such proponents, the annulment system thus far is perceived to have been unhelpful, unwieldy, heavily biased in favor of annulment, and a disguised means of obtaining two bites at the apple. Even if this were true, which defies the empirical and other experience, it is not entirely clear how an appellate structure would remedy or improve upon the annulment mechanism except insofar as it would be "staffed" on a consistent basis by a group of judges with long tenure who are meant to counteract the ad hoc, piecemeal approach to date.

Whether the ad hoc, piecemeal approach to date is in need of replacement is another matter altogether. On a certain level, the ad hoc, piecemeal annulment committee in an individual ICSID matter is arguably no more or less objectionable than the ad hoc, piecemeal judge or panel of judges in an individual ICC, UNCITRAL or other challenge proceeding before the Swiss Federal Tribunal, the Paris Court of Appeal or the US District Court for the Southern District of New York. While those state judges are civil servants with long tenure, that tenure per se does not necessarily guarantee long-term expertise in matters relevant to annulment of international arbitration awards. Admittedly, on the other hand, the concentration of competence and expertise now being aspired to in precisely these named courts does suggest a less ad hoc approach than that of the ICSID annulment committee mechanism.

Ultimately, each of the grounds addressed briefly above can be seen as providing a reasonable basis for considering an ICSID appellate structure, as also elucidated by Dr. *Tams*, but each one can also be turned on its head. In the final analysis, the most compelling obstacle to such a reform would be one of an entirely different, pragmatic nature: namely, the relative impracticality of seeking, let alone obtaining the necessary amendment to the ICSID Convention[8], in fulfillment of the stringent requirements for amendment.

For that reason alone, there may be little utility in taking a black-and-white position on the issue, although this can be found in recent other commentary.

8 Article 66(1) ICSID Convention provides: "(1) If the Administrative Council shall so decide by a majority of two-thirds of its members, the proposed amendment shall be circulated to all Contracting States for ratification, acceptance or approval. Each amendment shall enter into force 30 days after dispatch by the depositary of this Convention of a notification to Contracting States that all Contracting States have ratified, accepted or approved the amendment."

D. Dr. Tams' Mention of "Reference Proceedings"

The foregoing *tour d'horizon* of certain of the arguments for and against the implementation of an ICSID appellate structure or mechanism may serve, it is hoped, as a useful background to appreciate the interesting and creative remarks and study undertaken by Dr. *Tams*. In particular, they are meant to help in putting into perspective his discussion of "reference proceedings" in the context of this debate. Reference proceedings may be an alternative to the contemplation of an appellate structure, especially in view of the practical challenge of attempting to introduce such a structure by Convention amendment.

With the potential exception of intrepretative notes under NAFTA Article 1131, there is in fact no system of reference proceedings in ICSID or non-ICSID based investment arbitration. Article 1131(2) NAFTA[9] provides: "An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section." This is to be compared and contrasted with Article 64 ICSID Convention, which provides: "Any dispute arising *between Contracting States* concerning the interpretation or application of this Convention which is not settled by negotiation shall be referred to the International Court of Justice by the application of any party to such dispute, unless the States concerned agree to another method of settlement." [emphasis added]

Is possible analogous application of Article 1131(2) NAFTA a solution to the appellate structure approach, and in view of Dr. *Tams*' remarks?

On one level, the answer may be No, there are too many conceptual and other differences between NAFTA and ICSID. These include differences inherent in the simple fact that NAFTA is an MIT while ICSID is a Convention respecting dispute resolution relating to disparate BITS, MITS and also non-treaty disputes. Furthermore, there is a narrow tripartite focus of NAFTA versus the expansive, multilateral nature of ICSID.

On another level, and particularly in view of Dr. *Tams*' paper, the answer might well be Yes:

First, the Article 1131(2) NAFTA concept may be seen as existing in all cases as a matter of general treaty law. Thus Article 31(3) of the Vienna Convention on the Law of Treaties[10] provides: "[When interpreting a treaty], [t]here shall be taken into account […]: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions." The referral mechanism in NAFTA may be seen as having become a matter of general treaty law at least between and among the member states to the treaty. An analogous situation might

9 Available, *inter alia*, at http://www.investmentclaims.com/instruments/NAFTA%20Text%20%20-Excerpts.pdf.

10 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Vienna%20Convention%20on%20-the%20Law%20of%20Treaties.pdf.

be conceivable under ICSID, although again the requirement of an amendment may be unavoidable.

Second, Article 1131(2) NAFTA, at least in the narrow NAFTA context, has proven to be an effective, clear, time-efficient method for facilitating or even imposing clarity and uniformity, at least prospectively. The obvious example here is the NAFTA Free Trade Commission binding interpretation in 2001 respecting "fair and equitable treatment" under Article 1105 NAFTA as "not requir[ing] treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." There can be little doubt that – harking back to the discussion above of predictability, consistency, coherence and the like – this interpretation promptly contributed to a certain realignment of NAFTA jurisprudence.

Thus prior to the FTC interpretation the tribunal in *Pope & Talbot v. Canada* Partial Award (2001)[11] had held that "fair and equitable treatment" was an independent, self-contained, additive treaty standard. It gave a broad interpretation of Art. 1105 and imposed no threshold limitation that the conduct at issue be "egregious," "outrageous," etc. Acceptance of the narrower FTC interpretation followed in the *Pope & Talbot v. Canada* Final Award (2002)[12].

Then, in *Methanex v. US* (2005)[13], the tribunal stated that the FTC interpretation was binding not only as a matter of NAFTA law, but also pursuant to the general law of treaties, and that Article 1105 required showing the existence of an explicit rule of customary international law as being applicable to the case in order to establish a breach of the "Minimum Standard of Treatment."

NAFTA-based awards since the FTC binding interpretation continue to grapple with F&ET, but within the confines of the interpretation: *Mondev v. US* (2002)[14], *UPS v. Canada* (2002)[15], *ADF v. US* (2003)[16], *Loewen v. US* (2003)[17], *Waste Management v. Mexico* (2004)[18], *GAMI v. Mexico* (2004)[19], *Methanex v. US* (2005)[20], and *Thunderbird v. Mexico* (2006)[21].

11 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Pope-Canada-Award-10Apr2001.pdf.

12 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Pope-Canada-Damages-31May2002.pdf.

13 Available, *inter alia*, at http://www.naftaclaims.com/Disputes/USA/Methanex/Methanex_ Final_Award.pdf.

14 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Mondev-US-Award-11Oct2002.pdf.

15 Available, *inter alia*, at http://www.investmentclaims.com/decisions/UPS-Canada-Jurisdiction-22Nov-2002.pdf.

16 Available, *inter alia*, at http://www.investmentclaims.com/decisions/ADF-US-Award-9Jan2003.pdf.

17 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Loewen-US-Award-26Jun2003.pdf.

18 Available, *inter alia,* at http://naftaclaims.com/-Disputes/Mexico/Waste/WasteFinalAwardMerits.pdf.

Third, a system of binding interpretation within ICSID might be seen as doing violence to bilateral meetings of the minds in individually negotiated BITs and FTAs, including retroactively, but in fact would be fully consistent with Article 31(3) Vienna Convention on the Law of Treaties[22]. Such system, assuming it could be achieved through the necessary modalities of approval of an amendment to the ICSID Convention, would conceivably also prospectively contribute to harmonization and unification of drafting of certain typical, potentially open provisions.

These include respecting, *e.g.,* "fair and equitable treatment" and "full protection and security" in the context of "customary international law." They also include application of the proper law under the default provision in Article 42(1) ICSID Convention and supplementation of interpretation of a BIT through international law (*e.g.,* the issue in the *Wena* annulment proceedings[23]). They further include the validity of waiver of the right of annulment under Article 52 ICSID Convention, the meaning or standard of interpretation of "legal dispute" arising directly out of an "investment" under Article 25(1) ICSID Convention (e.g., *Mihaly International*[24]), and the meaning or standard of interpretation of "nationality" and "foreign control" under Article 25(2) ICSID Convention.

Fourth, issues such as arose in *SGS v. Pakistan*[25] and *SGS v. Philippines*[26] – assuming for the sake of argument that that discordance was an undesirable development – could be retroactively addressed for future cases, and even for applications for interpretation or correction within the current ICSID Convention Article 50(1) interpretation and correction scheme (*see, e.g., Wena v. Egypt*[27]). This provision states, "If any dispute shall arise between the parties as to the meaning or scope of an award, either party may request interpretation of the award by an application in writing addressed to the Secretary-General."

Fifth, the initial phase of three to five years would be one of uncertainty, instability, but perhaps no greater than what is currently occurring. After such initial phase,

19 Available, *inter alia,* at http://www.investmentclaims.com/decisions/GAMI-Mexico-FinalAward15Nov-2004.pdf.

20 Available, *inter alia*, at http://www.naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf.

21 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Thunderbird-Mexico-Award.pdf.

22 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Vienna%20Convention%20on%20the-%20Law%20of%20Treaties.pdf.

23 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Wena-Egypt-Annulment-5Feb2002.pdf.

24 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Mihaly-SriLanka-Award-15Mar2002-.pdf.

25 Available, *inter alia*, at http://www.investmentclaims.com/decisions/SGS-Pakistan-Jurisdiction-6Aug2003-.pdf.

26 Available, *inter alia*, at http://www.investmentclaims.com/decisions/SGS-Philippines-Jurisdiction-29Jan-2004.pdf.

27 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Wena-Egypt-Annulment-5Feb2002.pdf.

greater stability as to such points would occur: witness the NAFTA F&ET situation. Inconsistencies of the *Lauder*[28] variety would still occur, and perhaps should still occur, as in general commercial arbitration and litigation, but that would not be the focus of binding interpretation. And insofar as ICSID awards have a persuasive effect on non-ICSID investment-related disputes, including NAFTA, ICSID Additional Facility, UNCITRAL Rules[29] and Energy Charter Treaty[30], the ICSID binding interpretation could have a salutary effect on the uncertainties affecting various investment arbitration regimes.

Sixth, apart from the admittedly considerable obstacle of effectuating the necessary Convention amendment, a system of binding interpretation would be no more cumbersome and problematic, and arguably far less so, than various other proposals for establishment of an ICSID appellate structure, or for expansion of the ICSID annulment mechanism.

Ultimately, the chances of obtaining unanimous approval for an amendment of the ICSID Convention to institute such a mechanism may be slim, but perhaps no less slim than the chances of doing so to institute an "appellate structure." And such appellate structure might be far riskier in the conception and implementation, and also less consistent with the original goals of finality and unappealability of the Convention's original drafters. In any event, Dr. *Tams*' analysis of certain of the related issues in this debate is a valuable and perceptive contribution to a discussion which is likely to be only in its beginning stages.

28 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Lauder-Czech-FinalAward-3Sept2001.pdf,http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13 Sept2001.-pdf, http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001-Dissent.pdf, http://www.investmentclaims.com/decisions/CME-Czech-Appealof PartialAward-15May2003.pdf, http://www.investmentclaims.com/decisions/CME-Czech-FinalAward-14Mar2003.pdf, http://www.in-vestmentclaims.com/decisions/CME-Czech-FinalAward-14 Mar2003-Separate.pdf, http://www.invest-mentclaims.com/decisions/CME-Czech-AppealofFinalAward2003-15May2003.pdf.

29 Available, *inter alia*, at http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf.

30 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Energy%20Charter%20Treaty.pdf.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Christina Pfaff[*]

A. Introduction

At the dawn of the twenty-first century foreign investment and the protection of foreign investor rights belong to the most innovated fields in international law. The International Centre for the Settlement of Investment Disputes (ICSID)[1], the specifically specialized arbitral institution for the settlement of investment disputes has shaped, with enormous success, both the development and interpretation of many legal standards and guarantees in international investment law[2]. This success is based on certain unique advantages. ICSID is attached to the World Bank, unlike any other international arbitral institution. Due to the status of the World Bank[3] most countries may be more likely to observe ICSID obligations[4], which can improve the

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1 BGBl. 1969 II, p. 1191; the convention is also available at <www.worldbank.org/icsid /basicdoc/basicdoc>; the implementation of the ICSID Convention was based on the attempt of the drafters to attain a „careful balance between the interests of investors and host states,", see further *Delaume*, ICSID Arbitration and the Courts, 77 Am. J. Int'l L., p. 784 (1983); *Smutny*, Arbitration before the International Centre fort he Settlement of Investment Disputes (2002), Business Law International B.L.I., p. 367; *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 38; *Fahmi/Shihata*, The experience of the International Centre for Settlement of Investment Disputes (1999) ICISD Review, p. 299-369.

2 The number of cases before ICSID increased considerably after the invocation of arbitration under the NAFTA (North American Free Trade Agreement); see generally *Bishop/Crawford/Reisman*, Foreign Investment Disputes (2005), p. 11; it is important to note, however, that the ICSID Convention does not contain any comprehensive rule on the protection of foreign investment, but only the procedural framework, see Art. 42 (1) ICSID Convention.

3 See generally *Fahmi/Shihata*, The dynamic evolution of international organizations: the case of the World Bank (1999), Journal of the History of International Law, p. 217-249; *Tschofen*, The World Bank in a changing world (1995), p. 52.

4 *Fahmi/Shihata*, Avoidance and settlement of disputes - the World Bank's approach and experience (1999) International Law Forum, p. 90-98; *Görs*, Internationales Investitionsrecht-Vom völkerrechtlichen Enteignungsschutz zum europäischen Binnenmarkt (2005), p. 74; in that sense also *Slaughter*, The future of international law is domestic – or the European way of law, Harvard International Law Journal (2006), p. 338.

protection of investment in return[5]. ICSID is based upon an international treaty, the ICSID Convention[6]. Any breach of any obligation under the ICSID Convention implies a violation of international law[7]. Moreover, investment liberalization has been carried out primarily by bilateral arrangements[8], such as the Bilateral Investment Treaties (BITs)[9]. These agreements are entered into by trading partners and determine a consensus on the conditions of foreign investment and investor remedies between the parties[10]. Most of these BITs refer to ICSID for dispute resolution[11].

But after forty years of ICSID the time has come to not only to take stock of the work of the tribunals under the ICSID Convention, but to take potential alternative approaches to the field of foreign investment protection into account. While activities of the ICSID Tribunal have been in the centre of academic discussion for a long

5 *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97-102.

6 *Lörcher*, ICSID Schiedsgerichtsbarkeit (2005), SchiedsVZ, p. 12; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97 (99).

7 *Lörcher*, ICSID Schiedsgerichtsbarkeit (2005), SchiedsVZ, p. 11.

8 *Stoll*, WTO-Handbuch (2002), Chapter C. I. 6., para 2; *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 38-40; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97.

9 Direct foreign investment is protected by a network of over 2400 Bilateral Investment Treaties (BITs) involving 176 countries and additionally a vast number of provisions in plurilateral and multilateral treaties concerning investment protection or international trade. These BITs have been set into function over the past 40 years and provide a legal framework for international investment on the bilateral level. They contain relatively similar provisions and create actionable standards of conduct for governments regarding the treatment of foreign investment, though the arrangements bind only the parties involved.

10 The establishment of ICSID led to an increase of legal certainty with regard to investment disputes, see *Nathan*, Submissions to the International Centre for the Settlement of Investment Disputes in Breach of the Convention (1995) J.Int.Arb., p. 27 and *Fahmi/Shihata*, Towards a Greater Depoliticalization of Investment Disputes: The Roles of ICSID and MIGA, (1986), ICSID Review FILJ, p. 3; *Schäfer*, Enteignungsstandards im Völkerrecht, RIW (1998), p. 193.

11 See <www.worldbank/icsid/about/about.>; *ICSID Secretariat*, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper 22 October 2004, para 5; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 99; in addition consensus on jurisdiction of ICSID can also be determined in multilateral agreements such as the NAFTA and the Energy Charter Treaty, see *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 35; *Schreuer*, The ICSID Convention: A Commentary (2001), Art. 25, para 257; *Broches*, Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965 – Explanatory Notes and Survey of its Application (1993), YCA, p. 627, 643, para 35; *ibid.*, Denying ICSID's jurisdiction (1996), Journal of International Arbitration, p. 21-30; *Hirsch*, The Arbitration Mechanism of the International Centre fort he Settlement of Investment Disputes (1993), p. 48 (51), *Lew/Kröll/Mistelis*, Comparative International Commercial Arbitration (2003), Chapter 28, para 48.

period and debated extensively[12], the protection of foreign investment by other mechanisms has been much less considered. A number of international treaties dealing with the protection of (foreign) property are based upon international law[13]. In spite of the presence of property protection in both texts of international human rights and international trade law, the role of these instruments in the context of foreign investment protection remained largely irrelevant and research on this particular issue remained scarce. In addressing this gap, the present study, with due regard to the complexity of the issues, seeks to increase the level of understanding of the role of human rights and international trade mechanisms in the area of foreign investment protection, drawing on an analysis on the specific aspects of foreign investment protection in international human rights and trade law.

The emerging code of human rights provides a set of standards that apply to every sector of human interaction. In the context of foreign property protection human rights law and institutions comply with the basic rules of aliens' law, which is based on the international law principle of diplomatic protection[14]. The concept of diplomatic protection as based on the traditional view according to which the individual constitutes only a mere part of the State is founded on the traditional *do ut des* approach[15] in general international law. Understanding the instrument in such fashion limits the role of international human rights law with respect to foreign property protection. A new generation of international human rights treaties emerged and tackled this classical approach by granting treaty rights to all individuals[16]. Thus these treaties serve the benefit of all individuals, irrespective of their citizenship, and the international legal community, as its observance is monitored by all state parties equally. Yet, the protection of foreign investment and the protection of foreign property in general international law are footing on different goals: Human rights[17] together with aliens' law aim at a certain detachment of the individual from the state as well as a civilized conduct among states while the law on foreign investment protection focuses at protecting foreign investment as such. These differences have

12 See *Schreuer*, The ICSID Convention - A Commentary (2001), Art. 25, paras 92 –125 and the references cited.

13 *E. g*. the European Convention on Human Rights, which talks about international law in general in its Art. 1 of the First Additional Protocol.

14 *Diplomatic Protection* is to be understood as the protection given by a subject of international law to individuals, *i. e.* legal or natural persons, against a violation of international law by another subject of international law, see *Geck*, Diplomatic Protection, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. I (1992), p. 1046.

15 The *do ut des* approach is also defined as the concept of reciprocity; see further *Parisi/Ghei*, The role of reciprocity in international law, Cornell International Law Journal (1968), p. 93-123. For a methodical approach see *Kahan*, The logic of reciprocity (2003) Michigan Law Review, p. 71-103.

16 *E. g*. the European Convention on Human Rights (1950), see Articles 24 and 44.

17 Human rights are defined as "those claims made by men, for themselves or on behalf of other men, supported by some theory which concentrates on the humanity of man, on man as a human being, a member of mankind.", *Dorwick*, Human Rights, Problems, Perspectives and Texts (1979), p. 8.

had a strong influence on the protection of (foreign) property by human rights instruments with regard to consistency and coherency issues in jurisprudence, and, as a consequence thereof, on the entire role of human rights institutions in the field of foreign investment.

Trade and investment are closely linked with each other[18]. Both are complementary and substitute strategies for business looking for access to foreign markets, and the realisation of new commercial opportunities[19]. As establishing a commercial presence in a foreign country is one of the modes of delivering services investment goes often hand in hand with trade in services as well. From an economic perspective, foreign investment is a core part of the linkage between global markets and international trade[20], because access to the markets through a commercial presence brings about foreign investment, which may lead to additional trade[21]. Both concepts appear as two sides of the same coin. This substantial overlap between trade and investment law leads to the World Trade Organisation (WTO) and their role in the context of foreign investment. Some WTO Agreements contain investment provisions, e.g. the *Agreement on Trade-related Investment Measures* (TRIMs) and the *General Agreement on Trade in Services* (GATS), but more or less as incidental matters to some main theme. In addition, the panels set up under the *Dispute Settlement Understanding* (DSU) had to deal with investment issues occasionally[22]. Yet, the close linkage between trade and investment sharply contrasts with the current role of the WTO in the field of foreign investment protection, in particular since investment appears as the "missing panel" in the system and no comprehensive multilateral agreement on foreign investment protection under WTO auspices could be successfully concluded[23].

18 See *e.g.*, *WTO*, Working Group on the Relationship between Trade and Investment, The Relationship Between Trade and Foreign Direct Investment, WT/WGTI/W/7, 18 September 1997.

19 *Sauve*, Advisor of the OECD's Trade Directorate (2003) emphasized this assumption by stating that „the absence of a creditable and coherent regime for international investment is particularly glaring at a time when investment (more than trade) has become the driving force of deepening integration in the world economy", Trade Rules behind Borders, Essays on Service, Investment and the New Trade Agenda (2004), p. 22 f.

20 *Lörcher*, ICSID-Schiedsgerichtsbarke*it* (2005), SchiedsVZ, p. 11; *Tietje*, Die Beilegung internationaler Investitionsstreitigkeiten, in Streitbeilegung in den internationalen Wirtschaftsbeziehungen, (*Marauhn,* ed.) p. 49.

21 See *Jessup*, A Modern Law of Nations (1968) 10, stating that "The function of the law of responsibility of States for injuries to aliens … is to provide in the general world interest, adequate protection for the stranger, to the end that travel, trade, and intercourse may be facilitated".

22 Panel Report, *Indonesia - Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R; WT/DS59/R; *Canada- Administration of the Foreign Investment Review Act* (FIRA), BISD 30S/140 (1984).

23 In this context, *Sauve* (supra note 19, p. 24) stated that the "patchwork quilt of different bilateral treaties, regional arrangements, and limited pluri-lateral or multilateral instruments relating to investment stands in sharp contrast to the comprehensive system of norms and principles governing international trade."

The task of this paper consists in illuminating the current state of foreign investment protection by other mechanisms than the ICSID focusing on human rights institutions and the WTO. It attempts to provide a survey on relevant human rights institutions and provisions of the WTO agreements dealing with foreign investment issues. The conceptual approaches to the issue of foreign investment protection in international human rights law and in international trade law are analyzed in order to draw conclusions on the advantages and disadvantages of each system from the investor's perspective. In addition, a critical look is taken at relevant court decisions rendered in the context of foreign investment protection. The paper does not, however, aim at comparing these mechanisms and their systems but instead points at the respective advantages and disadvantages of each mechanism, in particular as against ICSID. These considerations permit an evaluation of the elements which define the role of the human rights systems and the WTO system with respect to foreign investment protection.

The paper is structured as follows. As a starting point, Chapter B gives a brief overview of the historical development of foreign property protection in general international law. It focuses on the rule of diplomatic protection which as a concept has experienced an on-going adjustment to the development of general international law over the last decades. The traditional approach of diplomatic protection[24] appears to have somewhat changed, as rights and entitlements are accrued to the individual by human rights conventions. The conceptual understanding of the instrument has been defined and clarified by the jurisprudence of the *Permanent Court of International Justice* (PCIJ) and the *International Court of Justice* (ICJ). Various court decisions, such as the *Barcelona Traction* Case, tackled the concept of the rule of diplomatic protection. The analysis of the decisions shows the continuing adjustment of the rule of diplomatic protection in general international law.

Chapter C provides an overview of the universal and regional human rights institutions playing a role in the field of foreign investment protection. In this context, the paper focuses on the category of treaties which accord treaty rights to all individuals and thus create a favourable legal position for foreign investors. The respective treaties as well as the pertinent jurisprudence are introduced and analyzed by identifying their specific features which render one instrument more or less suitable for foreign investment protection than another. Chapter C illustrates the principal characteristics of foreign property and investment protection in international human rights law and argues that international investment law and human rights are based on different grounds.

Next, Chapter D points at clarifying the role of the WTO in the field of foreign investment. This topic is approached by a short survey on the development of foreign investment protection within the WTO system. The core part of the Chapter focuses on the WTO agreements dealing with investment issues. The provisions of

24 The traditional approach of *diplomatic protection* determined the mediatisation of the individual entirely.

the agreements are examined with regard to the respective jurisprudence. The paper argues that despite the close linkage between trade and investment the current approach of the WTO to the field of foreign investment is dominated by the attempt not to include comprehensive investment provisions into the existing agreements due to conflicts attached to the issue. This assumption creates obstacles for a potential multilateral comprehensive agreement on foreign investment. These obstacles are illustrated and summarized in Part III which aims at defining overlaps and divergences between trade law and investment law as well as the need for a multilateral regime, in particular with regard to consistency and coherence in international jurisprudence. The paper concludes with part E, which evaluates the results of the analytical framework and assesses potential as alternative approaches to foreign investment protection as compared to the ICSID Convention.

B. The Protection of Foreign Property in General International Law

Fundamental to the protection of foreign investment is the concept of property. The protection of (foreign) property[25] by rules of international law has been subject to on-going controversial debates[26] and the question of property rights of aliens has become rather separated from that of a general minimum standard of protection. The traditional protection of foreign investment was based on the rules of aliens' law[27], in particular the international expropriation rules[28], as aliens may have claims against natural or legal persons and institutions in a foreign state[29]. Pursuant to the rules of international law only the home state of the foreign investor can assert

25 Alien property is determined by the effective power to enforce measures against such property, see *Seidl-Hohenveldern*, Aliens, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. I (1992), p. 116.

26 *Dolzer*, New Foundations of the Law of Expropriation of Alien Property , American Journal of International Law (1981), p. 553- 589; *Verwey*, The Taking of Foreign Property under International Law: A New Legal Perspective?, Netherlands Yearbook of International Law (1984), p. 3-96; *Borchardt*, The Diplomatic Protection of citizens abroad (1915), p. 8-56; *Slaughter/Tulumello/Wood*, International Law and International Relations Theory: A new Generation of Interdisciplinary Scholarship, American Journal of International Law 92 (1998) p. 367-397; *von Glahn*, Law among Nations; An Introduction to Public International Law (1996); *Frieden*, Invested Interests: The Politics of National Economic Policies in a World of global Finance, International Organizations 45 (1991) p. 425-451; *Seidl-Hohenveldern* (supra note 25) at 116 with further references.

27 *Ipsen*, Individualschutz im Völkerrecht, Zum völkergewohnheitsrechtlichen Mindeststandard, in Völkerrecht (*Ipsen,* ed.), § 50, para 2.

28 *Banz*, Völkerrechtlicher Eigentumsschutz durch Investitionschutzabkommen, insbesondere die Praxis der Bundesrepublik Deutschland seit 1959 *(*1988*)*, p. 135; *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 3.

29 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 135.

claims on the basis of diplomatic protection[30] in case of interferences with aliens' property. The rule of diplomatic protection reflects the traditional view in international law "that a State is in reality asserting its own rights- its right to ensure, in the person of its subjects, respect for the rule of international law."[31] Thus the link of nationality gives the state the right to protect its nationals against abuses by other states. The concept rests on the assumption that not individuals, but their home states are the holders of the rights granted in international law, as the individual is a mere part of its home state[32]. In addition the home state of the investor will not accept the exclusive power of the host state to judge on the legality of the taking and the amount of compensation due[33]. The exhaustion of local remedies is an obligatory prerequisite for the application of the rule of diplomatic protection[34].

The scope of the international law norms concerning protection of (foreign) property comprises not only the "classical" expropriation cases but also cases where measures tolerated or adopted by the host state impair and defeat the effective use of alien property as if it were deprivation of it[35]. International law does not exclude interference with alien property entirely, but interference with it may violate international discrimination rules, if such measures are directed exclusively against fo-

30 *Diplomatic Protection* is to be understood here as the protection given by a subject of international law to individuals, i. e. natural or legal persons, against a violation of international law by another subject of international law. The legal institution of *diplomatic protection* has been shaped by some important developments in the international legal community, e. g. by the evolution of human rights and by efforts to raise individuals more and more to the status of subjects of international law.

31 *Mavrommatis Palestine Concessions*, PCIJ, Series A, No. (1924); PCIJ, Series No. 5 (1925), judgment p. 6 at p. 12; c. f.; also *Barcelona Traction, Light and Power Company*, Judgment ICJ reports (1970), 45; separate opinion of Judge *Morelli*, at p. 222 (226).

32 This viewpoint is backed by the concept of reciprocity (traditional *do ut des* between states).

33 United States –Iran Agreement on 19 January 1981 (Hostages and Financial Arrangements); see *Aldrich*, What Constitutes a Compensable Taking of Property? The Decisions of the United States-Iran Claims Tribunal, 88 American Journal of International Law, (1994), p. 585 (610); *Baker/Davis*, Arbitral Proceedings under the UNCITRAL Rules - The Experience of the United States-Iran Claims Tribunal, 23 George Washington Journal of International Law & Economics (1989), p. 267 (347); *Briner*, Luncheon Talk: The United States-Iran Claims Tribunal and Disputes Involving Sovereigns, 18 Arbitration International 299 (2002); *Jones*, The United States-Iran Claims Tribunal: Private Rights and State Responsibility, 24 Virginia Journal of International Law (1984), p. 259 (285); *Lillich*, The United States-Iran Claims Tribunal, 1981-1983 (1985), p. 15 f.

34 The requirement that individuals first exhaust local remedies gives states – and particularly their domestic courts – an incentive to reach conclusions acceptable to the international institution so that the international court need not intervene to review the case; see e. g. the *Mavrommatis Concession* Case, PCIJ, Series A, No. 2 (1939), p. 6 at p. 12 of the 1924 judgment; *Panevezys-Saldutiskis Railway* Case, PCIJ, Series A/B, No. 76 (1939), p. 4 at p. 18*;* Electricity Company of Sofia Case, PCIJ, Series A/B, No. 77 (1939), p. 64 at p. 78 and *Interhandel* Case, ICJ Reports 1959, p. 6 at p. 27.

35 These measures are referred to as a „*creeping nationalization*" or a so-called „*constructive taking*".

reigners[36]. The host state has to grant minimum standard compensation[37] due for the taking of the property to citizens and aliens alike[38].

Recently, the International Law Commission (ILC), a permanent organ for the codification of international law[39] decided, subject to the approval of the General Assembly[40], at its forty-seventh session (1995) to include the issue of diplomatic protection on its agenda[41] and qualified the topic as appropriate for codification and progressive development in international law. At the fifty-eighth session (2006) the ILC adopted a text of draft articles concerning the rule of diplomatic protection and, thus, concluded its work on this issue[42]. The current draft version of the articles on diplomatic protection contains a chapter on general principles of diplomatic protection, such as a definition of term and scope[43]. The following chapters address *inter alia* the local remedies rule and the status of legal and natural persons[44]. The draft articles, however, deal only with the secondary rules[45], which are the rules relating to the conditions that must be met for bringing a claim for diplomatic protection. In

36 This problem was addressed in the *Chilean Copper Nationalization* Case by the Landgericht Hamburg, Chile-Kupfer Streit, Court Decision of 22 January 1973, Außenwirtschaftsdienst des Betriebsberaters (AWD), Vol. 19 (1973) p. 163-165 and Court Decision of 13 March 1974, AWD, Vol. 20, p. 410-413; English version available in ILM, vol. 12 (1973) p. 251-289 and ILM, Vol. 13 (1974), p.1115-1120; and the Tribunal de Grande Instance de Paris, Corporación de Cobre c. Societé Brade Copper Corporation et Societé du Groupement d'Importation des Metaux, 29 novembre 1972, clunet, vol. 100 (1973) p. 227-238, English version available in ILM, Vol. 12 (1973), p. 182-189; *Behrens*, Rechtsfragen im chilenischen Kupferstreit, Rabels Zeitschrift für ausländisches und internationales Privatrecht (1973), p. 394 (435); *Seidl-Hohenveldern*, Chilean Chopper Nationalization Cases before German Courts, American Journal of International Law , vol. 69, No. 1, (1975), p. 110-119.

37 The minimum standard is defined as *prompt, adequate and effective* compensation.

38 *Garcia-Amador*, Fourth Report on International Responsibility, YILC (1959 II) 1-36; *ibid.,* State Responsibility: Some new Problems*;* Recueil des Cours, vol. 94 (1958-II) , p. 365 (491); *Parry/Clive*, Some considerations upon the protection of individuals in international law*;* Recueil des Cours, vol. 90 (1956-II), p. 653 (726).

39 For a general survey see *Sir Vallat*; International Law Commission, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. II (1995) p. 1208-1212.

40 The General Assembly instructed the ILC in 1996 to further examine the topic and to define its scope and content in the light of the observations made during debates, Resolution 51/160 of 16 December 1996; see also A/51/358 and Add. 1. Pursuant to General Assembly resolution 51/160, the ILC established a Working Group on the topic at its forty-nine session (1997). The report of the Working Group was endorsed by the ILC, Yearbook ILC, vol. II, para 171.

41 See Yearbook ILC (1995), vol. II, para 501. Pursuant to General Assembly resolution 51/160 of 11 December 1996, the ILC included this topic on its agenda at its forty-ninth session (1997), Official Records of the General Assembly, Fifty-second Session, Supplement No. 10 (A/52/10), paras 169-171.

42 Report of the International Law Commission, Fifty-eighth Session (2006), Chapter IV, p. 16.

43 See Chapter I, Article 1 and 2; yet, the draft article makes no attempt to provide a complete and comprehensive definition of diplomatic protection. It rather defines the salient features of the rule in the sense in which the term is used in the present draft articles.

44 See Chapter II, Article 4 and Chapter III, Article 9.

45 The primary rules, which govern the treatment of the person and property of aliens, see Report of the International Law Commission, Fifty-eighth Session (2006), Chapter IV, p 22 (23).

addition, certain weaknesses inherent to the instrument, such as the protection of stateless persons[46] or the exhaustion of local remedies[47] as a prerequisite for the application of the rules of diplomatic protection were tackled by the draft codification. It is important to note that any rights resulting from either customary international law or bilateral or multilateral human rights treaties remain unaffected[48]. Ultimately, draft Article 17 deals with foreign investment, stating that "[t]he present draft articles do not apply to the extent that they are inconsistent with special rules of international law, such as treaty provisions for the protection of investment." The article contributes to treaties, which, within their provisions concerning dispute resolution, exclude or depart substantially from the rules governing diplomatic protection. BITs or the multilateral ICSID Convention are the primary examples of such treaties[49]. Their provisions for dispute resolution allow direct access of the investor to international arbitration and dispense with the conditions for the exercise of diplomatic protection. Avoiding political uncertainty as an inherent factor in the nature of diplomatic protection is another advantage for dispute resolution in accordance with these respective treaty provisions. The ILC draft articles are notably based on the jurisprudence rendered by international tribunals with regard to the instrument of diplomatic protection.

46 Article 8 of the draft version.

47 Article 14 of the draft version; Article 15 determines recognized exceptions from the local remedies rule.

48 A state may protect an individual in inter-state proceedings under the International Covenant on Civil and Political Rights (United Nations, Treaty Series, vol. 999, p. 171), the International Convention on the Elimination of All Forms of Racial Discrimination (article 11), the Convention on Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (United Nations, Treaty Series, vol. 1465, p. 85, art. 21), the European Convention on Human Rights (article 24), the American Convention on Human Rights (art. 45) and the African Charter on Human and People's Rights (United Nations, Treaty Series, vol. 1520, p. 217, arts. 47-54), see draft article 16.

49 Article 27 (1) of the ICSID Convention reads: „No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.", see United Nations, Report of the International Law Commission, Fifty-eighth Session (2006), p. 89 (90).

I. Historical Development of Investment Protection in International Law

During the eighteenth and nineteenth centuries foreign investment was largely made in the context of colonial ambitions[50]. Notions of collective ownership of property which were widely prevalent in the colonies were replaced by European notions of individual property[51]. The common form of foreign investment of these days was indirect, through loans and government bonds, and foreign direct investment, on which this paper is focused, started to take shape only in the late nineteenth century. The increase of such foreign direct investment was promoted by two independent, but interrelated developments, which were, on the one hand, the rapidly increasing rate of technological invention and, on the other hand, the growth of corporations. When the host governments expropriated property of investors from another state, the government of the investor would provide *diplomatic protection*[52], which is defined as the exclusive right of the state to pursue treaty rights beneficial to its nationals in the international context[53]. The claims based on the rule of diplomatic protection were commonly dealt with by ad hoc tribunals or mixed claims commissions to adjudicate the claims. The instrument of diplomatic protection allowing for the intervention of the government of the investor led to conflicts with the host government. This development culminated in the formulation of the "*Calvo-Doctrine*"[54], which embodied the Latin American version of the principle of equality between nationals and aliens due to the abusive exercise of the right of diplomatic protection[55]. The doctrine promulgated that foreign investors were entitled to treat-

50 During the nineteenth century, optional treaty standards hardened into rules of international customary law or became considered as general principles of law recognised by civilised nations. These standards require the compliance of the rule of law (in the meaning of the continental *Rechtsstaat*), the right to full, prompt and effective compensation and the exhaustion of local remedies.

51 This protection was to ensure that colonial legal systems were changed in order to accommodate European notions of individual rights of property and freedom of contract.

52 See *Lillich*, The Diplomatic Protection of Nationals Abroad: An Elementary Principle of International Law Under Attack, American Journal of International Law, vol. 69, No. 2 (1975), p. 359-365; *Gramlich*, Diplomatic Protection Against Acts of Intergovernmental Organs, German Yearbook of International Law, vol. 27, (1984), p. 386 (428).

53 At that time diplomatic protection was usually pursued through exchanges of diplomatic notes between the governments or espousing a formal claim on behalf of the investor as a state national on a government to government basis.

54 The name of the doctrine refers to the Argentinean diplomat and jurist *Carlos Calvo*, who shaped the „*Calvo*-Doctrine" in 1868. The doctrine states that "aliens who established themselves in a country are certainly entitled to the same rights of protection as nationals, but they cannot claim any greater measure of protection."

55 Some American States suspected *diplomatic protection* to be a potential instrument for stronger states in order to achieve economic intervention, intrusion into their domestic jurisdiction, imperialism and neo-colonialism.

ment no different or better than citizens of the host state[56]. According to the doctrine, foreign investors were to have their claims heard by the courts of the countries where they invested, but they were not entitled to seek the diplomatic protection of their governments or to have claims presented to international tribunals. The doctrine has been embodied in some international instruments: on the Seventh International Conference of the American States[57] the *Calvo-Doctrine* was explicitly incorporated into the Convention on Rights and Duties of States[58]. Nevertheless the *Calvo-Doctrine* proved to be no obstacle to legal actions based on violations of established international obligations referring to the treatment of aliens, as the international responsibility was drawn into question[59].

In the beginning of the twentieth century, foreign investment disputes were widely brought about by land reform measures in certain countries, such as the transformation of the entire Czarist economy in the Soviet Union to socialism in 1917 and the disruptions of World War I. Prior to 1917 a common understanding, the *traditional consensus* among the principal nations existed which embodied the obligatory rule of prompt and adequate compensation in case of a state taking an alien's property[60]. In addition, states adhered to the rule of diplomatic protection in its traditional sense. This situation changed in connection with the Russian Revolution[61] and World War I and led to the denial of private property in the Soviet Union

56 *Calvo* assumed that the acknowledgment of the minimum international standard would lead to „an exorbitant and fatal privilege, essentially favourable to the powerful States and injurious to the weaker nations, establishing an unjustifiable inequality between nationals and foreigners, *Garcia-Amador*, Calvo Doctrine, Calvo Clause, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 521, 522; *Shea*, The Calvo Clause, A Problem of Inter-American and International Law and Diplomacy; Modern Law Review, vol. 20, No. 4, (1957), p. 428-429.

57 The First International Conference of American States was held in Washington in 1889/1890 and the Seventh Conference in Montevideo in 1933. The formulation was officially adopted in the following words: "1. Foreigners are entitled to enjoy all the civil rights enjoyed by natives; and they shall be afforded all the benefits of said rights in all that is essential as well as in the form or procedure, and the legal remedies incident thereto, absolutely in like manners as said natives; 2. A nation has not, nor recognizes in favour of foreigners, any other obligations or responsibilities than those which in favour of the natives are established, in like cases, by the constitution and the laws.", see also *Scott*, The International Conferences of American States, 1889 to 1928 (1931), p. 45.

58 The Convention states that „Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may not claim rights other more extensive than those of the nationals" (Art. 9); the doctrine was also taken up in another inter-American instrument, the 1902 Convention Relative to the Rights of Aliens (Art. 2).

59 *Shea*, The Calvo Clause, A Problem of Inter-American and International Law and Diplomacy, Modern Law Review, vol. 20, No. 4, (1957), p. 428-429.

60 See Art. 46 II Fourth Hague Convention of 1907, which states that „private property cannot be confiscated".

61 See *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 18 and references cited there in footnote 24.

between 1917 and 1962[62]. The end of World War I witnessed the establishment of the Permanent Court of International Justice (PCIJ)[63]. This court rendered two leading decisions referring to the matter of diplomatic protection and the protection of alien's property in the 1920s: the *Oscar Chinn* Case and the *Mavrommatis Concessions* Case.

The end of World War II was accompanied by the imposition of socialist economies in Eastern Europe, the nationalization of certain industries in Western Europe[64] and the independence of former colonial territories. These developments caused an increasing number of foreign investment disputes which needed to be resolved. Thus the rules of international customary law were reaffirmed[65]. In this period of time property rights including the right to compensation for expropriation have been included in the Universal Declaration of Human Rights (1948), the European Convention on Human Rights (1950), the American Convention on Human Rights (1969) and the African Charter on Human and People's Rights (1981)[66]. These instruments grant, irrespective of the principle of reciprocity (*do ut des*), the treaty rights to everyone regardless of e. g. nationality, which brought about a legal emancipation of the individual and led to a somewhat different understanding of the concept of diplomatic protection. The Cold War period brought further conflicts[67], as a section of the world proclaimed its adherence to the "*Hull-Rule*"[68], while other large

62 See *Degras*, Soviet Documents on Foreign Policy, vol. I (1951), p. 98 (Decree of the Council of People's commissars on the General and Legal Conditions for Concessions, 23 November 1920); Mexico followed Russia by changing its constitution in the sense that no protection of property whatsoever was guaranteed.

63 The Permanent Court of International Justice did its best to stigmatise the measures of liquidation of enemy property under the Peace Treaties of 1919 as exceptions from the traditional rules of international law as well as to reaffirm the minimum standard of international law on the protection of foreign property. The court made it clear beyond doubt that once a breach of international standards occurred, it was irrelevant if the state concerned applied the same treatment to its own nationals. Non-discrimination was not to be regarded as a justification for a violation of the minimum standard of international law, see *Roth,* The Minimum Standard of International Law applied to Aliens (1949), p. 81.

64 France and the United Kingdom.

65 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 187.

66 In addition, these rights have been included in the constitutions of many countries and private initiatives to address the treatment of foreign investors were set off: the International Chamber of Commerce (ICC) adopted the International Code of Fair Treatment of Foreign Investors in 1949.

67 See *inter alia* the United States Supreme Court, stating in 1962: "There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens", *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, at p. 428 (1964). The "social function of property" and the "redistribution of wealth" competed with the traditional Western concepts of private property and protection of aliens.

68 The *Hull*-Rule is named after the American Secretary of Foreign Affairs, *Cordell Hull*, calling for prompt, adequate and effective compensation, see 32 Am.J. Int'l L., Supp., p. 181-207 (1938). The Hull-Rule proclaimed adequate and partial rather than full compensation and was therefore met by heavy criticism, see further *Schwarzenberger*, Foreign Investments and International Law (1969), p. 7 (8).

sections of it regarded this rule and its equivalents as tailor-made for imperialist powers. Many socialist countries banned foreign direct investment in their territories altogether. Treaties of Friendship, Commerce and Navigation (FCN) were negotiated by a few countries in the upcoming period to regulate the treatment of foreign investment. Furthermore the International Court of Justice was newly formed[69]. In 1962 the UN General Assembly adopted Resolution 1803[70] to express the traditional consensus[71] determining specific conditions in case of expropriation or nationalization of property[72].

After the pronouncement of Resolution 1803 the World Bank drafted a Convention, which was supposed to set up a proper institutional framework for the settlement of investment disputes[73]. The result of these endeavours is the ICSID-Convention[74], which came into force in October 1966 only eighteen months after its drafting[75]. The Convention created the International Centre for the Settlement of Investment Disputes to administer arbitrations between contracting governments and investors of other states. The Convention does not provide a specific rule of international law on a comprehensive basis for the future development of the protection of international investment, but institutional rules and administrative and financial

69 In 1952 the ICJ found it lacked jurisdiction on an investment dispute between the British government and Iran in the case *Anglo-Iranian Oil Co*. (United Kingdom v. Iran), Judgment of 22 July 1952.

70 UN General Assembly Resolution 1803 (XVII), 14 December 1962, Permanent Sovereignty over Natural Resources.

71 The traditional consensus determined that "nationalization, expropriation or requisitioning have to be based on grounds or reasons of public utility, security or the national interest. These have to be recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law…", General Assembly resolution 1803 (XVII), 14 December 1962, Permanent Sovereignty over Natural Resources. The Charter of Economic Rights and Duties of States (UN G. A. Resolution 3281 (XXIX) of December 12, 1974) stipulates that each State has the right „ to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless [otherwise agreed]" (Art. 2 (2) (c)).

72 The resolution was met by heavy criticism, as it determined a trend towards further vagueness, which was illustrated by terms such as „appropriate compensation" (adopted in Res. 1803) or the formula of „reasonable, adequate and reasonable prompt" compensation, see further *Friedmann*, A.S.I.L. Proceedings (1963), p. 127 (128); *ibid.*, Restatement of the Law, Second – Foreign Relations Law of the United States (1965), p. 563; *Metzger*, Law of International Trade, vol. I (1966), p. 112 *et seq*.

73 So far it can be stated that the ICSID Convention is still representing the consensus reached in Resolution 1803.

74 See BGBL. 1969 II 369.

75 *Schreuer*, The ICSID Convention: A Commentary (2001), p. 4, mn. 10.

regulations for the settlement of disputes[76]. In the 1970s the consensus found in Resolution 1803 and the standards for treatment of foreign investment as well as the content of the international law that governs it began to be drawn into question by a growing number of developing states regarding the issue of economic decolonization[77]. As a result thereof, many industries were nationalized by Third World governments[78]. In 1974 the United Nations General Assembly adopted Resolutions 3201 (S-VI) and 3281 (XXIX) in order to establish a so-called "New International Economic Order". The Charter of Economic Rights and Duties of States accorded to reach state the right "to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless [otherwise agreed]."[79]

Both resolutions were backed by a majority of the developing states, as they asserted each country's right to a free choice of its economic system as well as the right to exercise sovereignty over its natural resources. But the assumptions of the 1960s and 1970s regarding the tension between foreign investment and economic decolonization revealed to be erroneous[80]: In the 1980s it became evident that coun-

76 Pursuant to Article 42 of ICSID Convention "the responsible arbitration courts have to settle the dispute on the grounds of the law of the state involved" and to apply "such rules of international law as may be applicable".

77 This relates to the issue of „permanent sovereignty of natural resources", the matter of the "New Economic Order" and the Charter of Economic Rights and Duties of States of 1974 (UNYB 1974, 402); see *Dolzer*, Wirtschaft und Kultur im Völkerrecht, in Völkerrecht, (*Vitzthum,* ed.), 6. Abschnitt I 3 e, para 30, 31 and 6. Abschnitt I 3 a , para 44-47; *Gloria*, Völkerrechtlicher Eigentumsschutz, in Völkerrecht (*Ipsen* ed.), § 47, para 1; United Nations, Department of Economic and Social Affairs, The External Financing of Economic Development (1968 – E.68.II D.10), Section 84, p.31; *Schwarzenberger*, Foreign Investment and International Law (1969), p. 7; *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 24 (25).

78 Implementing such policies the Libyan government under the leadership of *Mu'ammar Qaddafi* nationalized in 1971 the petroleum industry, Kuwait in 1980 the petroleum interests of the American Independent Oil Company and Chile from 1955 to 1973 the copper mining companies, see generally *Sornarajah*, The Clash of Gobalisation and the International Law on Foreign Investment, at a Symposium at the Norman Paterson School of International Affairs on 12 September 2002, p. 4.

79 Art. 2 (2) (c) UN-Res. 3281; legal sovereignty in international law determines that a sovereign state may exercise its sovereignty only subject to compliance with all other rules of international law, see *Larson*, Sovereignty within the Law (1965), p. 332.

80 The world total investment abroad at the end of 1966 was estimated at $ 90 billion. Accumulated foreign direct investment by capital exporters in less developed countries were estimated to have amounted to $ 30 billion at the end of 1966. Between 1964 and 1966, the annual private capital export from members of the Development Assistance Committee (D.A.C.) of the Organisation for Economic Co-operation and Development (OECD) to developing countries averaged $ 3, 5 billion, of which $ 2 billion were private investment, OECD Background Paper on Private Investment in Less Developed Countries, 6 May 1968 (Press/A (68) 23, p. 2).

tries acting hostile to foreign investment were being left behind in the race for economic growth and aliens' property was considered as an asset of the host state.[81] The law on foreign investment has witnessed an explosive growth ever since[82]. In the 1990s the fall of socialism and the dissolution of the Soviet Union gave a significant impetus for an improvement of the climate for foreign investment. A remarkable consensus[83] could be generated concerning the standards for treatment of foreign investment. The USA drafted a Model BIT, which served as a role model for many BITs coming into effect and concluded a regional Free Trade Agreement, the North American Free Trade Agreement (NAFTA) in the 1990s[84]. These BITs were followed by the Energy Charter Treaty in 1994 which is dealing with investment issues in the energy sector, and the idea to bring about an international foreign investment regime accelerated. In 1996 the WTO implemented a "Working Group on Foreign Investment" with the task to negotiate such multilateral agreement which, however, failed to achieve this goal[85]. The dynamic development of foreign investment law found its most ambitious initiative in the unsuccessful effort taken by the OECD to

81 Developing countries are becoming more important as host countries for foreign direct investment (FDI) activities. Their share of global FDI flows increased from 21 % in 1991 to 36 % in 1997. Despite the crisis in financial markets in Asia at the end of the twentieth century, FDI flows into developing countries in Asia remain strong and reached the mark of $ 78 billion, UNCTAD, Investment Report (1999). Today the 48 less-developed countries (LDCs) remain marginal recipients of FDI receiving only 2% of all FDI to developing countries and 0.5% of the global total. But among the top ten in terms of absolute increases, eight were developing countries, led by Mexico, China and South Africa. Conversely, among the ten countries experiencing the steepest declines in FDI in flows, eight were developed countries (Belgium, Luxembourg, the United States and Germany reported the largest declines).

82 From 1980 until today the world-wide investment flows increased enormously: compared with the world-wide trade increase the annual percentage has increased about six fold. These numbers fluctuate depending on the state of the world-wide economy, see <http://www.unctad.org/en/docs/wir2005overview_en.pdf>. The global FDI Stock is a measure of the investment underlying international production. In 1996, the global FDI stock valued $ 3.2 trillion. Its rate of growth over the past decade was more than twice that of fixed capital formation, indicating an increasing internationalization of production systems, see *UNCTAD*, Investment Report (1998); in 2001 the book value of the FDI valued approximately $ 6, 8 trillion, International Monetary Fund Statistics Department, Foreign Investment Trends and Statistics (2003).

83 The consensus was named the "*Washington Consensus*". The term referred to the alliance between the US Government, the International Monetary Fund and the World Bank, which are all located in Washington D. C.

84 *Sornarajah*, The Clash of Globalisations and the international law on foreign investment, The Simon Reisman Lecture in International Trade Policy, Symposium at the Norman Paterson School of International Affairs on 12 September 2002, p. 3.

85 *Graham*, A note why multilateral negotiations failed at the OECD, and how such negotiations might be crafted to succeed at the WTO, Private Investments abroad – Problems and Solutions in international Business (1999), p. 3-9; for a comparative study see *Kurtz*, A general investment agreement in the WTO – Lessons from Chapter 11 of the NAFTA and the OECD Multilateral Agreement on Investment, Jean Monnet Working Paper (2002), p. 73.

draft a comprehensive Multilateral Agreement on Investment (MAI)[86]. The favourable climate for foreign investment was damped by a succession of economic crises, in particular in Asia at the beginning of the twenty-first century and set the initial stage for a new evaluation of foreign investment law.

II. Leading Court Decisions

Not only scholars were involved in the process of the conceptual evolution of property protection in international law and the interpretation of pertinent treaty law, which shaped the development of alien property and investment protection, but also certain courts and arbitral tribunals: In particular, the *Permanent Court of International Justice* (PCIJ) and the *International Court of Justice* (ICJ) had to deal with cases raising issues of alien property and investment protection.

1. The Permanent Court of International Justice

The Permanent Court of International Justice was the precedessor of the International Court of Justice[87]. The idea of furthering the peaceful settlement of international disputes was first raised in 1899 and 1907 at The Hague Peace Conference. The Convention on the Pacific Settlement of International Disputes was adopted, which dealt not only with arbitration but also with other methods of peaceful settlement such as good offices and mediation. The convention made provisions for the creation of permanent machinery for dispute resolution[88] and in 1902 the Permanent Court of Arbitration started operating[89]. At the Second Conference proposals were made to establish a Permanent International Court which resulted in a draft for the

86 The MAI resulted in the abandonment of the initiative because of anti-globalisation protests aiming at the implementation of restrictions for multinational corporations. As consequence, many countries withdrew from the initiative; see generally *Muchlinski*, Towards a multilateral agreement on investment (MAI), the OECD and WTO models and sustainable development, in International economic law with a human face (*Weiss* ed.), (1998) p. 429-451; *Karl*, Das Multilaterale Investitionsschutzabkommen (MAI), RIW, (1998), p. 432 (440); *ibid.*, On the way to multilateral investment rules- some recent policy issues (2002), ICSID Review, p. 293-319; *ibid*., Internationaler Investitionsschutz - Quo vadis? (2000), Zeitschrift für vergleichende Rechtswissenschaft, p. 143 (169); *Brewer*, Investment Issues at the WTO: the Architecture of Rules and the Settlement of Disputes, Journal of International Economic Law, vol. 1, No. 3 (1998), pp. 457.

87 See <http://www.icj-cij.org/icjwww/ibluebook.pdf>.

88 The said machinery was to enable arbitral tribunals to be set up as desired and to facilitate their work.

89 The convention further created a Permanent Bureau, which was and still is located at The Hague. The Bureau assumed functions corresponding to those of a court registry and laid down a set of rules of procedure to govern the conduct of arbitration.

initial set up of an international tribunal[90]. Between 1911 and 1919 several plans were submitted by national and international bodies and governments for the establishment of a permanent international judicial tribunal after the war[91]. After 35 sessions the Committee of Jurists, which was convened by the Council of the League of Nations, adopted a draft scheme for the Statute of the Permanent Court of International Justice (PCIJ). These endeavours culminated in the creation of the PCIJ within the framework of the new international system after World War I by the League of Nations. The PCIJ started its operative work in 1922 and was dissolved in 1946.

a) The Chinn Case[92]

In Congo, then a colony of Belgium, a British citizen[93] established a transport business on the sea. The business was attached to a company, *Unatra*, with a majority of its shares held by the Belgian State itself. Because of the commercial depression in 1930/1931 the Belgian government decided to subsidize the export trade of Congo by decreasing tariffs for certain products up to 75 %. *Unatra* experienced a loss of profits in return and received compensation. As a result of this change of tariffs, the British citizen was unable to compete and closed down his business without receiving any reimbursement or compensation. Thereupon the United Kingdom, in consent with the Belgian government, submitted the case to the PCIJ raising the question whether the Belgian measures constituted a breach of international law. In its judgment, the court held the measures of the Belgian government to be in accordance with international law. In this respect, the *Convention of Saint-Germain-en-Laye* served legal basis for the judgment[94]. In the interpretation given the court stressed that the said convention would not oblige Belgium to create an atmosphere of equal commercial conditions[95]. Therefore alleging unlawful discrimination on behalf of its citizen by the British government could not prevail as *Unatra* was in a different position. In line with these findings the court held that the measures of the

90 The draft was not adopted at the Second Conference because of differences of opinion concerning issues of jurisdiction. The draft was attached to the Final Act of the 1907 Conference under the title „Projet d'une Cour de Justice Arbitrale".

91 These plans, sometimes in conjunction with plans for a world organization, were mostly based on initiatives of independent academic bodies, notably the British Fabians Society and the American Society for the Judicial Settlement of Disputes.

92 *Oscar Chinn* Case, Judgment, PCIJ, Series A/B, No. 63 (1934), p. 65-152.

93 *Oscar Chinn*, PCIJ, Series C, No. 75.

94 *Dolzer*, Chinn Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 579-580.

95 The court assumed that *Oscar Chinn* had been aware of the favourable position of *Unatra*, see Series A/B, No. 63 (1934), p. 69.

Belgian government in question did not result in a violation of vested rights[96]. The judgment received much attention due to its pronouncements on expropriation and discrimination, although the court's understanding of these terms hardly mirrors the current approach to international law in this respect.

b) The Mavrommatis Palestine Concessions Case[97]

The Permanent Court of International Justice also addressed the issue of diplomatic protection in the *Mavrommatis Palestine Concessions Case*[98]. Before World War I, a Greek national, *Mavrommatis*, signed two agreements with the Ottoman Empire, on concessions for the construction and exploitation of works necessary for the distribution of public electricity and water in Palestine. After the beginning of World War I the parties of the agreements postponed their execution. After the peace settlement process *Mavrommatis* addressed the government of Palestine with the question when to put the concessions into operation. According to the Peace Treaties signed after World War I, the Allied Powers should continue to enjoy the rights acquired in Palestine before the beginning of World War I. In addition, Great Britain was entrusted with the mandate for Palestine. For this reason the British government concluded an equivalent agreement with another applicant, which provided for the right of the applicant to require the expropriation of any concessions conflicting with his rights. *Mavrommatis* continued to submit plans for execution of the concessions to the British government, but when these were eventually rejected, he claimed restitution for violation of his rights.

On behalf of its national, the Greek government exercised diplomatic protection by addressing the PCIJ with an application to institute proceedings against the British government. The court accepted jurisdiction after rejecting objections regarding the issue of jurisdiction raised by the British government[99]. In its judgment the court

96 The court excluded the possibility of making profit from the scope of protection of vested rights, stating that „Favourable business conditions and good-will are transient circumstances, subject to inevitable changes …", see Series A/B, No. 63 (1934), p. 88.

97 *Mavrommatis Concession Case*, PCIJ, Series A, No. 5 (1925); *Doehring*, Mavrommatis Concessions Case, in Encyclopedia of Public International Law, in *R. Bernhardt* (ed.), vol. III, (1981), p. 330 (332).

98 See PCIL, Series A, No. 25 (1925).

99 See PCIL, Series A, No. 25 (1925), Judgment of 8 August 1924 (PCIJ A 2).

held that *diplomatic protection* was an elementary principle of international law[100]. Thus, in the judgment the court found that *Mavrommatis* was entitled to require that the concessions were being readapted to the new economic conditions, but not to compensation payment[101]. After two years, the Greek government submitted another application alleging the breach of international obligations by the British government as it refused to approve new plans submitted by *Mavrommatis* on 5 May 1926 until December 1926. In return, the British government repeated its objections against jurisdiction of the PCIJ as without the express consent of both parties, the Court could not claim jurisdiction to decide whether one of its judgments had or had not been complied with. In addition, the government denied the violation of international obligations within the meaning of the respective mandate. In its judgment[102] the court upheld the objections alleged by the British government on the question whether it had jurisdiction to supervise the fulfilment of terms of a previous judgment. Moreover, the court emphasized the exhaustion of local remedies as a substantial requirement for the application of the rules of *diplomatic protection*[103]. The 1925 judgment contributed therefore to the development of the rule of diplomatic protection. In particular the affirmation of the concept of *diplomatic protection* was considered a huge step forward in the context of foreign investment protection by general international law.

2. The International Court of Justice

After World War II a system for the peaceful settlement of disputes should be set up including an international judicial institution[104]. As a consequence thereof, it was agreed upon convening a "United Nations Conference on International Organization". At the Yalta Conference in 1945 the statute for an international court was

100 See PCIL, Series A, No. 25 (1925), p. 6, para 12: "[i]t is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State; in so doing, a state was in reality asserting its own rights … [For] in the eyes of [an international tribunal] the State is the only claimant", the entire judgment is also available at <http://www.icjcij.org/cijwww/cdecisions/ccpij/serie_A/A_02/06_Mavrommatis_en_Palestine_Arret.pdf>. The dictum was repeated by the Permanent Court of International Justice in the *Panevezys Saldutiskis Railway* Case (Estonia v. Lithuania), P.C.I.J. Reports (1939), Series A/B, No. 76, p. 16.

101 See PCIL, Series A, No. 5, Judgment of 26 March 1925 (PCIJ A 5).

102 Readaption of the *Mavrommatis Palestine* Concessions, PCIJ, Series A, No. 11 (1927), judgment of 10 October 1927 (PCIJ A 11).

103 *Mavrommatis Concession* Case, PCIJ, Series A, No. 5 (1925), p. 6 at para 12 of the 1924 judgment.

104 *Jessup*, Do New Problems Need New Courts?, American Journal of International Law, vol. 65 (1971), p. 261-268; for a short survey see *Tornaritis*, The review of the Role of the International Court of Justice, revHellen, Vol 24 (1971), pp. 34; *Lillich*, The deliberative Process of the International Court of Justice, A Preliminary Critique and Some Possible Reforms, American Journal of International Law, vol. 7 (1976), p. 28.

drafted which was modelled on the Statute of the PCIJ, as most provisions were taken verbatim from the revised version. The Statute of the International Court of Justice (ICJ)[105], the "World Court", was adopted in conjunction with the Charter of the United Nations on 26 June 1945 and came into force on 24 October 1945. So far, the ICJ has only infrequently been confronted with investment disputes: Yet, the court rendered two post-war[106] leading decisions. As only states can appear before the ICJ, the claims were espoused by the states on behalf of their nationals. These two decisions continue to be of outstanding importance in the context of the development of foreign property protection by international law: (1) The *Barcelona Traction, Light and Power Co. Ltd. (Belgium v. Spain)* Judgment[107] of 1970 and (2) the *Elettronica Sipula S.p.A. (USA v. Italy)* Judgment[108] of 1989.

a) The Barcelona Traction Case

The foundations of property protection were indirectly addressed in the ICJ decision in *Barcelona Traction* in connection with matters of diplomatic protection of legal persons. Belgian nationals, both natural and legal persons, were shareholders of a Canadian holding company, the *Barcelona Traction, Light and Power Company Ltd.* The company issued several series of bonds, partly in pesetas and sterling. In context with the Spanish civil war the bonds interest payments were refused and not resumed. Spanish shareholders submitted a petition for a declaration on bankruptcy which was followed by the Spanish courts and the assets of the company were seized. Various legal actions against the declaration of bankruptcy remained unsuccessful. In 1951 the corporate capital was sold entirely in the shape of new shares at

105 According to Article 92 of the Charter of the United Nations, the International Court of Justice is established as the "Principal judicial organ of the United Nations."

106 One of the most famous Pre-War Court Decisions together with the *Oscar Chinn* Case and the *Mavrommatis Palestine* Concession Case was the Case concerning *Chorzow Factory*, PICJ, Ser. B, No. 3 (1925), p. 1-36, which dealt with the issue of restitution in international law. The dictum affirmed the idea of restitution as a primary remedy in international law. The court stated in its judgment that "the essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral decisions – is, that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear", see PICJ Series A, No. 17 at 47, which resulted in a pronouncement on the responsibility of the host state to foreign investors. The judgment is also available at <http://www.worldcourts.com/pcij/eng/decisions/1927.07.26_chorzow/>.

107 *Barcelona Traction, Light & Power Co. Ltd* (Belgium v. Spain), ICJ Reports, 1970 I.C.J. 3, 42, 42-50 (Feb 5); see also Wallace, Barcelona Traction Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 346-349.

108 *Elettronica Sicula S. p. A.* (ELSI), Judgment, ICJ Reports (1989), p. 115-121, available at <http://www.icj-cij.org/icjwww/icases/ielsi/iels.ijudgments/icsli.ijudgment19890720.pdf>.

public auction and purchased by a Spanish company. The Belgium shareholders did not receive any reimbursement or compensation for their loss.

Belgium applied to the ICJ[109] and alleged reparation for the damage caused "on account of acts said to be contrary to international law committed by organs of the Spanish State", including "the deprivation of the enjoyment of rights", and leading to the "total spoliation of the Barcelona Traction group."[110] In return, the Spanish government raised objectives regarding the discontinuance of the proceedings, but also a lack of *jus standi* of Belgium and the exhaustion of local remedies. The court acknowledged that Belgium was acting on behalf of natural and legal persons, but followed the last two arguments of the Spanish government[111]. The decisive factor in this context was whether the Belgian government was entitled to provide diplomatic protection for the Belgian shareholders though their losses resulted not from an injury to the "direct rights" of the nationals[112]. The final judgment rendered rejected the claims of Belgium on the grounds of lacking *jus standi* [113] and concluded the application of diplomatic protection only to be granted when exceptional circum-

109 ICJ Pleadings, *Barcelona Traction*, Light and Power Company Ltd. (Application 1958); New Application 1962, vols. I-X.

110 The application was discontinued when in 1961 Belgium attempted to negotiate an out-of-court settlement, which was objected by the Spanish government. The case was submitted to the ICJ by a new application of Belgium in 1962.

111 See para 102 of the judgment. In addition, the court denied any analogy with regard to the *Nottebohm* Case, Judgment, ICJ-Reports 1955.

112 The court stated in this respect that "…an act directed against and infringing only the companys rights does not involve responsibility towards the shareholders, even if their interests are affected. … The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law orders confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action", see *Barcelona Traction* Case, ICJ Reports (1970), p. 36, paras. 46-47; see also p. 33, where the court held that „From its origins closely linked with international commerce, diplomatic protection has sustained a particular impact from the growth of international economic relations, and at the same time from the profound transformations which have taken place in the economic life of nations".

113 In this respect, the court stated "that the adoption of the theory of diplomatic protection of shareholders as such, by opening the door to competing diplomatic claims, could create an atmosphere of confusion and insecurity in international economic relations. The danger would be all the greater inasmuch as the shares of companies whose activity is international are widely scattered and frequently change hands;" *Barcelona Traction* Case, ICJ Reports 1970, p. 4; separate opinions of Judge *Jessup* paras 44-57, 80 and Judge *Gros*, paras 22, 24.

stances occur[114]. Likewise, the principle of diplomatic protection of corporations was clarified in the sense that a corporation is to be protected by the State of nationality of the corporation and not by the State or States of nationality of shareholders in a corporation[115]. The decision met heavy and well-founded criticism which was based mainly on the argument that "the court seems to have raised a host of complex issues and to have resolved almost none"[116]. The opportunity to clarify and develop legal standards in international commercial litigation and in international law in general had not been taken[117].

b) The Case concerning Elettronica Sicula S.p.A. (ELSI)[118]

The *Barcelona Traction Case* set the climate for the court decision concerning *Elettronica Sicula S.p.A.* (*USA v. Italy*): A company founded in Palermo/Italy, the *Raytheon ELSI S.p.A.* was owned almost entirely by an American company, the United

114 "In allocating corporate entities to States for purposes of diplomatic protection, international law is based, but only to a limited extent, on an analogy with the rules governing the nationality of individuals. The traditional rule attributes the right of *diplomatic protection* of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office. These two criteria have been confirmed by a long practice and by numerous international instruments. This notwithstanding, further or different links are at times said to be required in order that a right of diplomatic protection should exist. Indeed, it has been the practice of some states to give a company incorporated under their law *diplomatic protection* solely when it has its seat or management or centre of control in their territory, or when a majority or a substantial proportion of the shares has been owned by nationals of the state concerned. Only then, it has been held, does there exist between the corporation and the state in question a genuine connection of the kind familiar from other branches of international law. However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the genuine connection has found general acceptance. Such tests as have been applied are of a relative nature, and sometimes links with one State have had weighed against those with another." *Barcelona Traction* Case, ICJ Reports (1970), p. 4 at paras 32, 33, 42 and p. 48, para 92, where the court stated that "it is quite true that it has been maintained that, for reasons of equity, a State should be able, in certain cases, to take up the protection of its nationals, shareholders in a company which has been the victim of a violation of international law. Thus a theory has been developed to the effect that the state of the shareholders has a right of diplomatic protection when the state whose responsibility is invoked is the national state of the company. Whatever the validity of this theory may be, it is certainly not applicable to the present case, since Spain is not the national State of *Barcelona Traction*".

115 See *Barcelona Traction* Case, ICJ Reports 1970, p. 34, paras 40 - 44.

116 *Wallace*, Elettronica Sicula Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 348; in addition it was mentioned that the court in Barcelona Traction was guided by a number of policy considerations, see *ibid*. p. 48-49, paras 94-96, p. 48, paras 94, 95, p. 38, para 53, p. 50, para 98.

117 This suggestion is in accordance with the evaluation of Judge *Fitzmaurice* who stated that „general international law obligations in the sphere of the treatment of foreigners" have not been clarified, see separate opinion of Judge *Fitzmaurice*, ICJ-Report 1064, p. 65.

118 *Elettronica Sicula S.p.A.* (ELSI), Judgment, ICJ Reports (1989), p. 15-121.

States *Corporation Raytheon Company* and its subsidiary *The Machlett Laboratories*. Due to a continuing financial crisis of ELSI, the government of Italy was asked to provide subsidies or other governmental support to the company in order to avoid liquidation. After a refusal of the Italian authorities, representatives of Raytheon provided support for an orderly liquidation. The liquidation was prevented by an order released by the Mayor of Palermo which determined the requisitioning of ELSI's assets[119]. In response, ELSI submitted a petition for bankruptcy. ELSI was purchased by a state-controlled subsidiary substantially below its book value. In 1974 the United States of America declared to exercise diplomatic protection on behalf of *Raytheon* and *Machlett.* The U.S. government alleged violations of a bilateral treaty between the United States of America and Italy[120]. Pursuant to Article XXVI of this treaty, the ICJ had jurisdiction and thereupon the case was submitted to the court in February 1987. Italy argued that local remedies had not been exhausted, as the actions before the Italian courts had not been based on provisions of the bilateral treaty. In this respect, the court addressed the rule of customary law requiring the exhaustion of local remedies and found that the rule is "an important principle of customary international law"[121]. The ICJ acknowledged jurisdiction but then rejected the case[122] while discussing the scope of certain standards provided by the treaty[123]. The decision remained, in this respect, to be based mainly on a debatable evaluation of the facts[124]. Nevertheless, the ELSI decision had remarkable impacts on the development and interpretation of BITs, but, as before, the ICJ deprived itself of the opportunity to shape and construe international customary law.

119 The representatives of ELSI raised an appeal against the order immediately. The Prefect of Palermo declared the actions of the Mayor to have exceeded his power, but the decision was issued more than a year later.

120 The respective treaty is the Treaty of Friendship, Commerce and Navigation, concluded on 2 February 1948.

121 ELSI case, I.C.J. reports 1989, p. 15 at p. 42, para. 50. In this respect the Court also stated that "the local remedies rule does not, indeed cannot, require that a claim be presented to the municipal courts in a form, and with arguments, suited to an international tribunal, applying different law to different parties: for an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success."

122 The Court stated that "in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the State in which the investment was placed. States even more frequently provide for protection, (…), either by means of special instruments or within the framework of wider economic agreements. (…) No such instrument is in force between the Parties to the present case."

123 The Court discussed primarily Art. III and Art. V of the bilateral treaty, but dismissed the claims put forward by the United States in context with these articles.

124 See *Wengler*, Die Entscheidung des IGH im „ELSI"-Fall, Neue Juristische Wochenschrift, vol. 43, (1990), p. 619 (620).

3. Summary

The court decisions rendered by international tribunals in the area of foreign investment protection and presented in the section above mirror the developments carried out by international jurisprudence. Principles such as the exhaustion of local remedies[125] and the rule of diplomatic protection[126] were affirmed and cleared by dictums of the courts in the context of cases concerning foreign property protection. Nevertheless, most applicants before the international courts aimed at an award of restitution or the payment of compensation, but in particular the award of restitution has always been considerably rare in the jurisprudence of the World Court[127], which represents the main reason for the insignificance of the jurisprudence of the World Court in the area of foreign investment protection.

C. The Role of Human Rights Institutions

As foreign investment protection is fundamentally based on the idea of property, the protection of alien property forms an integral part of foreign investment protection in international law. In the past the protection of foreign property by human rights institutions was carried out by the instrument of classical diplomatic protection. In the early years of international law the individual had no own rights in the international legal order. As a consequence thereof, the protection of a national abroad was to be done only by means of the fiction underlying the instrument of diplomatic protection: that the home state was asserting its own rights[128]. A large number of treaties concluded by human rights institutions reflected the traditional approach to the rule of diplomatic protection and reciprocity as rules of international law. After World War II a new type of human right treaty was launched. The most significant characteristic of this treaty type is to grant the treaty rights to all individuals regardless of factors such as nationality[129]. By the emergence of a generation of treaties granting human rights to all individuals[130], human rights institutions formed a new conceptual understanding of the rule of diplomatic protection and diplomatic protection in terms of the classical conceptual understanding became largely superfluous.

125 See *Mavrommatis Palestine Concessions* Case, PCIL, Series A, No. 25 (1925).

126 See *Elettronica Sicula S. p. A.* (ELSI), Judgment, ICJ Reports (1989).

127 *Gray*, The Choice between Restitution and Compensation, European Journal of International Law, vol. 10 (1999), p. 413 (416).

128 In accordance with the traditional approach in international law an individual is a mere part of his home state and therefore cannot assert rights out of an international treaty. The State has the exclusive procedural right to decide on the material right on the international plane.

129 The European Convention on Human Rights (1950), the American Convention on Human Rights (1969) and the United Nations Human Rights Covenants (1966) represent the new generation of human rights treaties.

130 See *e. g.* Article 24 and Article 44 of the European Convention of Human Rights.

The new approach to the protection of the individual absent of classical diplomatic protection led to the emancipation of the individual from his home state under human rights conventions[131].

Given the existence of an absolute right to property, the investor would receive protection in absolute terms. Yet, there is no uniform understanding of property as an absolute right[132], because the concept is placed uneasily between distinct constitutional systems recognised in different parts of the world, one emphasizing the social function of property while the other follows the conceptual approach of an absolute right[133]. International human rights law concerning the protection of alien property needs to balance these divergent approaches, thus the international human rights law does not prohibit all forms of interferences with foreign property, as e. g. limitations on grounds of public good are lawful. The following section contributes to the protection of foreign property by human rights institutions by introducing and evaluating the applicable mechanisms.

I. Universal Human Rights Systems

Since World War II, in particular, human rights have achieved universal recognition and constitute a major concern of international law, but the first acknowledgement of the right to property as an internationally protected human right dates back to 1929 when the "*Institut de Droit International*" established in its "*Declaration des droits internationaux de'l homme*" the right to property as a human right[134]. Henceforth, by international agreements concluded on the universal level, international human rights law has created obligations upon States to recognize, respect and ensure these rights subject to their jurisdiction and to provide remedies in case of breach of obligations[135]. The international law of human rights includes a number of comprehensive international human rights treaties of which the *International Covenant on Civil and Political Rights* (ICCPR) is the principal instrument and the *Uni-*

131 *Geck*, Diplomatic Protection, in *R. Bernhardt* (ed.) Encyclopaedia of Public International Law, vol. I, (1992), p. 1059 (1060).

132 *Seidl-Hohenveldern*, Aliens Property, in *R. Bernhardt* (ed.), Encyclopedia of International Law, Vol. I, (1992), p. 118.

133 In the Commonwealth and the European systems of law the idea of property is that all individual property exists only to the extent that the interests of the society as a whole will permit it.

134 "Il est du devoir de tout Etat de reconnaitre a tout individu le droit égal a la vie, a la liberté et a la propriété, et d'accorder a tous, sur son territoire, pleine et entière protection de ce droit…"; see *Dolzer*, Eigentum, Entschädigung und Enteignung im geltenden Völkerrecht (1985), p. 127 (128).

135 Like all international agreements a human rights covenant or convention gives rise to remedies in favour of other State parties, and generally in favour of all other State parties equally; see for a general survey *Henkin*, Human Rights, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1992), p. 886-893.

versal Declaration of Human Rights is the accepted general expression of recognized human rights[136].

1. The Universal Declaration of Human Rights

In 1945 the Preparatory Commission of the United Nations recommended to the General Assembly to establish a Commission of Human Rights. The task of this body was to formulate an "International Bill of Rights"[137]. This proposal was followed and the United Nations Economic and Social Council (ECOSOC) established a Commission on Human Rights on 15 February 1946[138] and instructed the United Nations Secretariat to prepare a documented outline of the bill. Finally, on 10 December 1948, the United Nations General Assembly adopted the pertinent resolution as the Universal Declaration of Human Rights[139]. For the first time a common comprehensive international standard which should be guaranteed to every person was defined and the Declaration was the first enumeration, on the universal level, of human rights and fundamental freedoms. Thus it was proclaimed to be "an historic act, destined to consolidate world peace through the contribution of the United Nations toward the liberation of individuals from the unjustified oppression and constraint to which they are to often subject"[140]. Hence, it was agreed from the beginning, the Declaration should be followed by a binding convention to determine the implementation of the Declaration and establish an appropriate supervisory mechanism, the Covenant on Civil and Political Rights[141].

136 *Henkin*, Human Rights, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1995), p. 888; still, the human rights recognized in the Declaration or the Covenants are not declared to be absolute, as Art. 29 (2) of the Universal Declaration provides: „In the exercise of his rights and freedoms, everyone shall be subject only to such limitations as are determined by law, solely fort he purpose of securing due recognition and respect fort he rights and freedoms of others and of meeting the just requirement of morality, public order and the general welfare in a democratic society".

137 A draft of a proposed declaration was submitted by the representative of the United States which was modelled after the US Bill of Rights, see i. a. Department of State Bulletin, Dec. 7 1947, p. 1076; see also *Carrillo Salcedo*, Human Rights, Universal Declaration, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1995), p. 926.

138 It was decided that „the present Conference … could not proceed to realize such a draft … The Organization, once formed, could better proceed to consider the suggestion and deal with it through a special commission or by some other method. The Committee recommends that the General Assembly consider the proposal and give it effect", Documents of the United Nations Conference on International Organisation, San Francisco, 1945, vol. VI, p. 456.

139 UN General Assembly Resolution 217 (III); at that time, the United Nations had 56 members. 48 voted in favour, none against and 8 abstained.

140 See <http://www.udhr.org/history/A777.htm>.

141 As a resolution adopted by the General Assembly, the Universal Declaration of Human Rights is not in itself legally binding, but it is considered as an international standard and as such as part of the law of nations.

Some fundamental concepts constitute the basis of the Declaration: all human beings are born free and equal in dignity and rights[142], everyone is entitled to a social and international order in which the rights and freedoms set forth in the Declaration may be fully realized[143], and those rights determined in it apply to everyone without any form of discrimination whatsoever[144]. In Article 17 of the Declaration the right of every person to own property everywhere and of every kind is recognized[145], while the ownership of property is subject to the legislation and the laws of the respective country[146]. The issue of expropriation is addressed in the second paragraph, stating that "No one shall arbitrarily be deprived of his property"[147]. The wording of the provision is as general as Article 17 (1) and due to the vagueness much room is left for the application of national law.

2. The International Covenant on Civil and Political Rights

The International Covenant on Civil and Political Rights (ICCPR)[148] provides protection for an extensive catalogue of fundamental rights. The Covenant establishes a Human Rights Committee (HRC) consisting of eighteen members, who are independent experts being elected and nominated by the State Parties. These experts supervise the compliance of the Contracting Parties with the Covenant. They administer an optional inter-state complaint mechanism and consider individual petitions brought to the Committee pursuant to the ICCPR's First Optional Protocol[149]. The Committee is, however, not authorized to take any action but only to raise questions

142 See Article 1 of the Universal Declaration of Human Rights.
143 See Article 28 of the Universal Declaration of Human Rights.
144 See Article 2 of the Universal Declaration of Human Rights.
145 Article 17 reads that (1.) "Everyone has the right to own property alone as well as in association with others"; generally see also *Eide*, The Universal Declaration of Human Rights – A Commentary, (1992), Article 17 with further references.
146 See A7C.3/SR 126, p. 4, Art. 17. The drafting version contained an express reference explicitly referring to the situation under domestic law; it read: "the laws of the State in which the property is located", E/CN.4/AC.2/SR 8, p. 3. The reference was deleted during the drafting process.
147 Article 17 (2) of the Universal Declaration on Human Rights.
148 International Covenant on Civil and Political Rights, 16 Dec. 1966, entered into force 23 May 1976, G. A. Res. 2200A (XXI), U.N. Doc. A/6316 (1966), 99 U.N.T.S. 171.
149 Optional Protocol to the International Covenant on Civil and Political Rights, 16 December 1966, in force 23 March 1976, 999 U.N.T.S. 171.

with the reporting governments and make non-binding "general comments"[150] which the states that have accepted these optional procedures are expected to implement in good faith[151]. In addition, the ICCPR establishes the obligation for states to ensure that any person whose rights have been violated are entitled to "an effective remedy" and that it be determined by a competent authority. In case remedies do not exist, states must "develop the possibilities of judicial remedy" and ensure that it is afforded[152]. Mere formal incorporation of the treaty protections are considered insufficient if further measures such as developing new procedural guarantees or other legal institutions are required to bring them to full effect[153]. The right of property is not among the specific rights the Covenant grants, but it contains a non-accessory non-discrimination rule in its Article 26.[154] This rule determines equal treatment with regard to property between nationals and aliens. Reasonable and objective distinctions do not constitute a breach of Art. 26 ICCPR. Therefore specific distinctions are regarded as permissible differentiations. These permissible differentiations have been subject of decisions concerning foreign property protection.

The *Benes*-Decrees[155], issued in context with expropriations in the Czech Republic[156], gave rise to several communications to the Human Rights Committee. The

150 Under the ICCPR's Optional Protocol, following consideration of an individual complaint, the "Committee shall forward its views to the State Party concerned and to the individual", see Article 5 (4) First Optional Protocol to the ICCPR. Under the inter-state procedure, in cases where a solution is agreed to by the alleged violating party, the HRC shall "confine its reports to a brief statement of the facts and the solution reached." Where no solution is reached, "the Committee shall confine its report to a brief statement of the facts; the written submissions and record of the oral submission made by the State Parties concerned shall be attached to the report". In either scenario, the reports are issued to the State concerned.

151 VII United Nations, Blue Book Series, The United Nations and Human Rights 1945-1995, 61 (1995).

152 Article 2 (3) ICCPR.

153 Furthermore, Article 50 ICCPR obliges all parts of federal states to comply with the treaty provisions: "The provisions of the present Covenant shall exceed to all parts of federal states without any limitations or exceptions."

154 See e.g. Article 26 ICCPR.

155 The *Benes* Decrees are a series of decrees which were rendered during World War II and a short period after by the then President of Czechoslovakia, *Edvard Benes* who, as head of the Czechoslovak government-in-exile, exercised emergency powers from London and continued to do after his return Czechoslovakia at the end of World War II, see Europeans Parliament Resolution on the Czech Republic's application for membership of the European Union and the states of negotiations (Official Journal C 72 E of 21 March 2002. The following Decrees related to property and its confiscation. (a) Decree 5/1945 (19.5.1945) – Invalidity of certain property-related acts effected in the period of non-freedom; (b) Decree 12/1945 (21.6.45) – Confiscation and expedited distribution of agricultural properties of Germans, Hungarians, traitors and collaborators and certain organisations and institutes; (c) Decree 28/1945 (20.7.1945); (d) Decree 108/1945 (25.10.1945) Confiscation of enemy property and the national renewal funds.

decrees, formally still in force, claimed collective World War II responsibility of Germans and Hungarians living in Czechoslovakia. Persons belonging to these minority groups were deprived of many of their rights, in particular as concerned their property rights[157] and then expelled. Austria, Germany and Hungary have called for the repeal of the decrees. The legal validity of the decrees, though issued by an executive authority, has been approved[158] and the Czech Republic views the *Benes* Decrees as the basis of post-war Czechoslovak and later Czech legislation[159]. The Committee found in this respective that the restitution procedure as practised by the Czech Republic was in violation of Article 26 ICCPR, as it was based on the double requirement of Czechoslovak citizenship and permanent residency in the state's territory[160].

156 By virtue of the *Benes*-Decrees, 2.5 million ethnic Germans (*Sudetendeutsche*) and approximately 40.000 Hungarians lost their Czechoslovak citizenship, their landed properties due to expropriation measures based on the decrees and were exiled. These measures were carried out between 1945 and 1946.

157 Decree 12/1945 related to "the confiscation and accelerated allocation of agricultural property of the German and Hungarian persons and of those having committed treason and acted as enemies of the Czech and Slovak people."

158 The *Benes* Decrees were ratified by Constitutional Act No. 57/1946 of 28 March 1946, which states that "the Provisional National Assembly passed this Act to approve and declare as law the presidential decrees […] All presidential decrees were to be regarded as laws from the very beginning and constitutional decrees were to be regarded as constitutional acts."

159 The Czechoslovak Republic was transformed into the Czech Republic and the Slovak Republic on 1 January 1993. The legislation of the former Czechoslovak Republic maintained its legal validity after the transformation process.

160 UN Human Rights Committee, Communication No. 516/1992 *Simunek v. Czech Republic*, Nr. 516, para 11.6; confirmed in *Adam v. Czech Republic*, Nr. 586/1994, para 12.6; and *Blazek v. Czech Republic*, Nr. 857/1999, para. 5.8; see also *Des Fours Walderode v. Czech Republic*, Nr. 747/1997, para. 8.4.

The case *De Fours Walderode et al. v. the Czech Republic*[161] which was submitted to the Committee in 2001 is characterized by very specific facts: The applicant was born in 1904 in Vienna and a citizen of the Austrian-Hungarian Empire, but his family had settled in Bohemia since the 17th century, which was a kingdom of the empire. After the end of the First World War the applicant, as a resident of Bohemia, became a citizen of the newly created Czechoslovak State in 1918. Due to his German mother tongue his citizenship was automatically changed into German citizenship in 1939 by virtue of *Hitler's* decree of 16 March 1939. After the death of his father in 1941 he inherited property, the *Hruby Rohozec* estate, which was confiscated on the basis of *Benes* decree 12/1945 by the newly formed government and he was deprived of his citizenship which he retained some years later on account of his proven loyalty during occupation. After in 1948 a Communist government came into power the applicant was forced to leave Czechoslovakia in 1949 and returned to Prague only in 1991 after the "*velvet revolution*" of 1989 had taken place. He retained his Czech citizenship in 1992 and subsequently, on the legal basis of Restitution Law No. 243/1992 he reclaimed possession of the estate he had inherited from his father in 1941. The respective restitution law was amended in 1996 by replacing the condition of permanent residence by the condition of uninterrupted Czech/Czechoslovak citizenship from the end of the war until 1 January 1990. As consequence, the restitution agreement of 1992 was invalidated and could not serve as the legal basis for restitution, since the applicant has not maintained continuous citizenship. Notwithstanding his reacquisition of Czechoslovak citizenship the applicant has not received any restitution for the loss he suffered. In 2000 the applicant died but his wife pursued the claim.

The Committee found that the amendment of Law No. 243/1992 by the Law No. 30/1996 implemented a more stringent requirement of citizenship, since citizenship had already been required as a condition for restitution under Law No. 243/1992.

161 See UN Human Rights Committee, Communication No. 747/1997 on 30 October 2001, UN Doc. CCPR/C/73/D/7477/1997, *Dr. Karel Des Fours Walderode v. The Czech Republic*, CCPR/C/73/D/747/1997: 8.4. The Committee recalls its views in cases No. 516/1993 (*Simunek* et al.), 586/1994 (*Joseph Adam*) and 857/1999 (*Blazek* et al.) that "a requirement in the law for citizenship as an obligatory condition for restitution of property confiscated by the authorities makes an arbitrary, and, consequently a discriminatory distinction between individuals who are equally victims of prior state confiscations, and constitutes a violation of Article 26 of the Covenant. This violation is further expressed by the retroactive operation of the impugned Law. 9.1. The Human Rights Committee, acting under Article 5, paragraph 4, of the Optional Protocol, is of the view that Article 26, in conjunction with Article 2 of the Covenant, has been violated by the State Party. 9. 2 In accordance with Article 2, paragraph 3 (a) of the Covenant, the State Party is under an obligation to provide the late author's surviving spouse, Dr. *Johanna Kammerlander*, with an effective remedy, entailing in this case prompt restitution of the property in question or compensation therefore, and, in addition, appropriate compensation in respect of the fact that the author and his surviving spouse have been deprived of the enjoyment of their property since its restitution was revoked in 1995. The State party should review its legislation and administrative practices to ensure that all persons enjoy both, equality before the law as well as equal protection of the law".

The requirement of uninterrupted citizenship added by the amendment in 1996 led to an exclusion of the applicant and any others in that situation from restitution[162]. Therefore the Committee considered it discriminatory to require continuous Czech citizenship for someone who otherwise had the right to claim restitution of property confiscated on the basis of the *Benes* Decrees[163]. The Committee found that the measures carried out by the Czech government caused a violation of the non-discrimination rule of the Article 26 of the Covenant, since the Czech law discriminated aliens against nationals. Since the ICCPR does not grant the protection of property specifically, the non-accessory rule of non-discrimination has to serve as the legal basis for the equal treatment of aliens and nationals with regard to property protection. Nevertheless, the Committee renders only non-binding comments which are not enforceable and the implementation of these "views" is optional, thus proceedings before ICSID tribunals are far more effective and less time-consuming.

II. Regional Human Rights Systems

The three regional human rights conventions – European, American and African – are all cast in broad language to protect aliens as well as nationals[164] generally and

162 The Committee stated that "this raises an issue of arbitrariness and, consequently, of a breach of the right to equality before the law, equal protection of the law and non-discrimination under Article 26 of the Covenant", see No. 747/1997, § 8.3.

163 The Committee also ruled in favour of the applicant in the *Fabryova v. Czech Republic* case, when eligibility for compensation was denied while in similar cases the plaintiffs obtained restitution, see *Fabryova v. Czech Republic* (765/97), see *also Pezoldova* v. Czech Republic (757/97); the case of *Brok and Brokova* v. the Czech Republic was more controversial. The Committee observed that "legislation must not discriminate among the victims of the prior confiscation to which it applies, since all victims are entitled to redress without arbitrary distinctions", see No. 774/1997, § 7.3. The Committee found that the restitution laws of 1991 and 1994 "gave rise to a restitution claim of the author which was denied on the ground that the nationalization took place in 1946/1947 on the basis of *Benes*-Decree No. 100/1945 falls outside the scope of laws of 1991 and 1994. Thus, the author was excluded from the benefit of the restitution law although the Czech nationalization in 1946/1947 could only been carried out because the author's property was confiscated by the Nazi authorities during the time of German occupation. In the Committee's view this discloses a discriminatory treatment of the author, compared to those individuals whose property was confiscated by Nazi authorities without being subjected, immediately after the war, to Czech nationalization and who, therefore, could benefit from the laws of 1991 and 1994. Irrespective of whether the arbitrariness in question was inherent in the law itself or whether it resulted from the application of the law by the courts of the State party, the Committee finds that the author was denied his right to equal protection of the law in violation of article 26 of the Covenant", see *id*., § 7.4.

164 See Article 1 ECHR, stating that "the High Contracting Parties shall secure to everyone within their jurisdiction the rights and freedoms defined in Section I of this Convention".

with regard to property[165], although in detail, the wording of the respective clauses is not identical. The two more recent regional systems - the Inter-American and the African one - are modelled in part on the European Convention on Human Rights. The following chapter introduces and analyzes the three different systems and the respective jurisprudence to provide an overview on the human rights institutions playing a role on the regional level.

1. The European Convention on Human Rights

The drawing up of the Convention for the Protection of Human Rights and Fundamental Freedoms was set up by the Council of Europe and the Convention was opened for ratification in Rome on 4 November 1950[166]. It entered into force three years later in September 1953. The European Convention on Human Rights (ECHR) instituted the first regional Human Rights system. The Universal Declaration of Human Rights served as a model for the Convention and it was to pursue the beginning steps for a collective enforcement of certain rights set out in the Universal Declaration. The entry into force of the Convention was followed by fourteen protocols which have been adopted since. As amended further rights and liberties to those granted in by the Convention were added: Protocol 9 enables individuals to plead before the Court and now the Convention permits both states parties and individuals to bring communications against states adhering to the Convention. These developments led hand in hand with the accession of new Contracting States to an enormous increase of applications before the Court[167] which now functions on a permanent basis with full-time judges resident in Strasbourg. The European system was the first to establish an international court for the protection of human rights and a procedure for individual denunciations of human rights violations[168].

165 See *e.g.* the Preamble of the Inter-American Convention on Human Rights, which states that "the essential rights of man are not derived from one's being a national of a certain state, but are based upon attributes of human personality" and the Preamble of the African Charter: " … the reality and respect of peoples' rights should necessarily guarantee human rights".

166 See <http://www.echr.coe.int/Eng/Edocs/HistoricalBackground.htm>.

167 The number of applications registered by the Commission climbed from 404 in 1981 to 4750 in 1997 and the number of provisional files opened each year with the Commission overstepped 12000. After the implementation of Protocol 11 which came into force on 1 November 1998, the Court's case load increased at an unprecedented rate: the number of registered applications rose from 5979 in 1998 to 13858 in 2001, which equals an increase of approximately 130%. These circumstances were initiated to be resolved by a Ministerial Conference on Human Rights, which was held in Rome on 3 and 4 November 2000 to mark the 50th anniversary of the Convention. In 2004 44.100 new applications were lodged (a plus of 13% compared to 2003) and 32.500 applications were allocated to a decision body, at http://www.echr.coe.int/NR/rdonlyres/F2B964EE-57C5-4C86-8B8F-8B4B6095D89C/0/MicrosoftWordstatistical_charts_2004__internet_.pdf.

168 *Shelton*, Remedies in International Human Rights Law (2005), p. 108.

The drafting of a rule for the protection of property provided by the ECHR has been shaped by endless discussions and difficulties in finding a consensus on its formulation[169]. This difficulty is born almost entirely out of the historical background[170]: The preliminary version of the Convention did not contain any rule for the protection of property, but the Advisory Committee, an organ subsequent to the European Council endorsed the admission of a rule for the protection of property[171]. The proposal made in this respect by the Advisory Committee[172] was not backed on a broad basis by the Council, who then asked for an implementation of this guarantee in further amendments. This proposal was followed and the protection of property was introduced into Article 1 of the First Additional Protocol which entered into force on 20 March 1952[173]. Article 14 of the Convention prohibits any form of dis-

169 The members of the Council of Europe considered themselves sharing an "adequate common heritage of political traditions, ideals, freedom and the rule of law" to implement further certain of the rights contained in the Universal Declaration of 1948 (Cmd. 8969 (1953), p. 2); *Jacobs/White*, The European Convention on Human Rights (1996), p. 246; Due to the assertion of slavery and servitude, the protection of property was covered with oblivion; as in the International Covenant on Civil and Political Rights (1966), the term "property" appeared merely as a criterion of illegal discrimination; see further *Böckstiegel*, Die allgemeinen Grundsätze des Völkerrechts über Eigentumsentziehung, Eine Untersuchung zu Art. 1 ZP, 1963, p. 11; *Schwelb*, The Protection of the Right of Property of Nationals under the First Protocol, American Journal of Comparative Law, No. 12, 1964, p. 518; *Janis/Kay/Bradley*, European Human Rights Law (2000), pp. 16.

170 In addition, the protection of property rights as human rights raises particular problems, see generally *Schermers*, The international Protection of the Right of Property, in Protecting Human Rights: The European Dimension, in Essays in Honour of *Gerard J. Wiarda* (*Matscher/Petzold* ed.) (1988), p. 565.

171 See Travaux Préparatoires, vol. III (1976), p. 262.

172 «Toute personne, physique ou morale, a droit au respect de ses biens. Ses biens ne peuvent être soumis à confiscation arbitraire. Les présentes dispositions ne sauraient, toutefois, être considérées comme portant atteinte, de quelque manière que ce soit, au droit que possèdent les Etats de promulguer les lois nécessaires pour assurer l'utilisation de ces biens, conformément a l'intérêt générale».

173 See Article 1 of the First Additional Protocol of the European Convention on Human Rights which states the following: „ Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possession except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties." Due to the vagueness of the wording, difficulties regarding the interpretation of the Article arose, e. g. the general principles of international law that are referred to are the rules of general law on the expropriation of foreign property and not the general principles of international law recognised by civilised nations. Thus the requirement of compensation for expropriation, as postulated by international customary law, was incorporated in Article 1 of the First Additional Protocol.

crimination[174]. It must be stressed, however, that – in contrast to Article 26 ICCPR – Article 14 ECHR provides only for an accessory right to non-discrimination, i.e. only insofar as rights guaranteed in the Convention or any of its Additional Protocol are at stake. This situation has changed for those states for which Additional Protocol N° 12 which provides for a non-accessory right to non-discrimination similar to the one enshrined in Article 26 ICCPR has entered into force. The scope of the right established in the Additional Protocol is broadly framed and permissible restrictions are widely drawn. According to the Court, the respective Article in the Additional Protocol No.1 comprises three distinct, but connected rules[175], which are the peaceful enjoyment of property, the deprivation of possessions as subject to certain conditions and the right of the state to control the use of property in accordance with the general interest. The certain conditions which have to be met when deprivation of property is exercised have posed difficulties of interpretation[176]. The said conditions are *inter alia* the principles of general international law which refer to the principles which have been established in general international law with regard to the confiscation of property of aliens.[177] Therefore measures exercised by a state against its own nationals do not fall within the scope of these general principles of international law[178] and the nationals are in a different legal position from that of the alien[179].

The impact of the jurisprudence of the ECtHR on the protection of foreign investment might appear in a deceptive light, since foreign investment requires investment undertakings in another state than the national state of the investor and no such case has been decided before the ECtHR up to now[180]. Yet, the Court has given

174 According to Article 14, "the enjoyment of rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

175 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1421; *Jacobs/White*, The European Convention on Human Rights (1996), p. 247.

176 The European Convention on Human Rights accords priority to social interests over individual property rights, in particular when health and safety of the society at large are threatened by the recognition of the individual rights to property, in that sense also *Ruffert*, The Protection of Foreign Investment by the European Convention on Human Rights?, German Yearbook of International Law, vol. 43 (2000), pp. 117 (131), (139-141).

177 *Schwelb*, The Protection of Property of Nationals under the First Protocol to the European Convention on Human Rights, American Journal of Comparative Law (1964), No. 12, p. 518.

178 See App. *1870/63, X v. Federal Republic of Germany*, 16 December 1965 (1965) 8 Yearbook, 218, 226, where the Commission held that Article 1 of the First Additional Protocol does not require a state which deprives its nationals of their possessions in the public interest and subject to the conditions provided for by the law to pay compensation, see also *Lithgow and others v. United Kingdom*, Judgment of 8 July 1986, Series A, No. 102.

179 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1458).

180 *Schöbi*, Der Schutz des Eigentums in Europa, Recht - Zeitschrift für juristische Ausbildung und Praxis, vol. 18 (2000), p. 78; *Peukert*, Artikel 1 des Ersten Zusatzprotokolls, in EMRK Kommentar (*Frowein/Peukert* eds.), 1996, para 22 with note 67.

general interpretations to the text of the Article 1 of Protocol No. 1. In the Case *Sporrong and Lönnroth*[181] the Court ruled that the entitlement to the peaceful enjoyment of possessions means the right to hold property. According to the state of facts two properties had been affected by the existence of construction prohibitions and expropriation permits for many years without compensating the owners for their losses incurred during these periods. The interference with the propertys' function caused by the said regulations was considered not to equal a deprivation and the applicability of the second sentence of the first paragraph was denied[182]. The Court had to determine whether a fair balance was struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights[183]. It concluded, however, that the said balance was, as a requirement of proportionality, inherent in the whole of the Convention and concluded a breach of Article 1 of the First Additional Protocol[184].

In the Case *James v. United Kingdom*[185], the leading case on the issue of expropriation, the ECtHR held that the principles in question are applicable exclusively to aliens, because they were specifically developed for their benefit and, as such, they would not relate to the treatment of nationals by their own state[186]. The case concerned the loss of immovable property in Belgravia, London, by virtues of the leasehold reform in the late 1960s[187]. The Court reasoned that the reference to international law allowed non-nationals access to the implementation machinery of the Convention for property protection instead of seeking for diplomatic protection[188] and concluded that since non-nationals were considered more vulnerable to domestic legislation as they were not part of the electorate and could not influence the adoption of laws, nationals were imposed a greater burden in the public interest[189]. With regard to the standard of compensation the Court held that on the legal basis of Arti-

181 *Sporrong and Lönnroth v. Sweden*, Judgment of 23 September 1982, Series A, No. 52, 81983 5 EHRR 35.

182 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1451).

183 *Sporrong and Lönnroth v. Sweden*, Judgment of 23 September 1982, Series A, No. 52, 81983, 5 EHRR 35, para 69.

184 In that sense also *Wiesinger v. Austria*, Judgment of 30 October 1991, Series A, No. 213 (1993) 16 EHRR 258, and *Holy Monasteries v. Greece*, Judgment of 9 December 1994, Series A, No. 301-A; *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1453).

185 *James v. United Kingdom*, Eur. Court H.R., Judgment of 21 February 1986. Series A, No. 98, para 37.

186 See footnote 185, paras. 58-66.

187 See for a survey *Mendelson*, The United Kingdom Nationalisation Cases and the European Convention on Human Rights, British Yearbook of International Law, vol. 57 (1986), p. 33 (73).

188 *James* v. *United Kingdom*, Eur. Court H.R., Series A, No. 98, para 62.

189 See footnote 188, para. 63.

cle 1 of the First Additional Protocol a full compensation could not be guaranteed in every situation[190].

The *Wasa Liv Omsesidigt* Case[191] dealt with two companies which had brought an application against the Swedish government and alleged that its tax legislation concerning insurance companies constituted a breach of Article 1 of the First Additional Protocol. The European Commission rejected the case after finding that the application was ill-founded. In the *Darby* Case[192] the issue of taxation was also in the fore of attention, when a Finnish doctor resident in Sweden was taxed as a Swedish resident by the Swedish administrative authorities and therefore had to pay the entire church tax. He opposed these decisions and applied to the ECtHR, which rightly held that tax obligations fall within the scope of the second paragraph of Article 1 of the First Additional Protocol and opened the admissibility of considering a discriminatory effect of the Swedish tax regulations under Article 14 ECHR.

Another case concerning the issue of expropriation of foreign property was addressed in is the *Prince Hans-Adam II of Liechtenstein v. Germany* case[193]. The applicant initiated a claim *inter alia* for restitution of property, namely for a painting confiscated by the former Czechoslovakia in 1946 under *Benes*-Decree 12/1945[194] and alleged a violation of Article 1 of the First Additional Protocol[195]. He argued in this respect that the confiscation, as a violation of international law, had to remain ineffective. Challenging in particular the validity of the said expropriation, the applicant argued that, as heir, he was the owner of the painting concerned. In the applicant's submission, the restitution of the painting in question to the Czech Republic amounted to an unlawful interference with his "existing possessions". The confiscation of the painting by the former Czechoslovakia under *Benes* Decree No. 12 had been unlawful, since his father had been neither "German" nor an "enemy of the Czech and Slovak people" [196]. The applicant's father filed a claim, but on 21 November 1951 the Bratislava Administrative Court dismissed the appeal. In 1991 the municipality of Cologne obtained the painting as a temporary loan from the *Brno Historical Monuments Office* in the Czech Republic and the applicant requested for an interim injunction ordering to the City of Cologne to hand over the painting. He formed a file before the cologne Regional Court requesting for consent to the deli-

190 See above note, para. 54.

191 *Wasa Liv Omsesidigt v. Sweden*, 58 Eur. Ct. H.R. 163 (1988).

192 *Darby v. Sweden*, Judgment of 23 October 1990, Series A, No. 187; (1991) 13 EHRR 774; see also *Gasus Dosier und Fördertechnik GmbH v. The Netherlands*, Judgment of 23 February 1995, Series A, No. 306-B.

193 Eur. Court H. R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*; Application No. 42527/98.

194 Decree 12/1945 (21. 6. 1945) – Confiscation and expedited distribution of agricultural properties of Germans, Hungarians, traitors and collaborators and certain organisations and institutes, see Chapter C. I. 2.

195 The applicant also alleged a violation of Art. 6 (1) of the ECHR.

196 Eur. Court H.R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*; Application No. 42527/98, para. 79.

very of the painting. In several proceedings the German courts found they lacked jurisdiction and as consequence the applicant then filed an application before the ECtHR. The ECtHR dismissed a violation of property rights under Article 1 of the First Protocol on grounds of the scope of the term "possession"[197]. In this respect the Court stated "the hope of recognition of the survival of an old property right cannot be considered a "possession" within the meaning of Article 1 of Protocol No.1. In these circumstances, the applicant as his father's heir cannot, for the purposes of Article 1 of Protocol 1, be deemed to have retained a title to property nor a claim to restitution against the Federal Republic of Germany amounting to a legitimate expectation in the sense of the Court's case law. The Court thus concludes that there has been no violation of Article 1 of Protocol No. 1 and observes that the expropriation carried out by authorities of former Czechoslovakia in 1946, as confirmed by the Bratislava Administrative Court in 1951, that is before 3 September 1953, the entry into force of the Convention, and before 18 May 1954, the entry into force of Protocol No. 1. Accordingly, the Court is not competent *ratione temporis* to examine the circumstances of the expropriation or the continuing effects produced by it up to the present date"[198]. The ECtHR ruled that the *Benes* Decrees could not violate the ECHR and rejected the application.

As discussed above, both the Commission and the ECtHR have taken a broad view of the interpretation of Article 1 of the First Additional Protocol[199]. In this respect several judgments were rendered defining and clarifying its scope[200], but foreign direct investment has, up to now, not been addressed directly by the Court[201]. In addition, expropriation of a foreigner's property was uncommon among the traditional members of the members of the Convention[202] and the ECtHR is considerably reluctant to recognize the existence of an expropriation or any other

197 See also *Malhous v. the Czech Republic* (Dec.) No. 33071/96, 13 December 2000, ECHR 2000-XII and *Mayer & Others v. Germany* , application No. 18890/91, 19048/91 and 19549/92, Commission Decision of 4 March 1996, Decisions and Reports 85, p. 5-20.

198 Eur. Court H.R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*, paras. 79-87.

199 See ECHR of 23 September 1982, Series A752; *Sporrong and Lönnroth v. Sweden*: 60. "…Although the expropriation permits left intact in the law the owner's right to use and dispose of their possessions, they nevertheless in practice significantly reduced the possibility of its exercise. They also affected the very substance of ownership…The applicants' right of property thus became precarious and defeasible…the justification for the interference with the applicants' right of property", and ECHR on 18. February 1991, Series A/192, Fredin; ECHR on 19 December 1982, Series 0A/169, *Mellacher* and ECHR on 7. December 1976, Series A724.

200 Continuous jurisprudence since Eur. Court H.R., *Handyside* Case, Judgment of 7 December 1976, Series A, No. 24, para. 62; *Marckx* Case, Judgment of 13 June 1979, Series A, No. 31, para. 63.

201 See footnote 180.

202 *Böckstiegel*, Enteignungs- und Nationalisierungsmaßnahmen gegen ausländische Kapitalgesellschaften, Völkerrechtliche Aspekte, Bericht der Deutschen Gesellschaft für Völkerrecht, vol. 13 (1974), pp. 7.

measure which would result in restitution and/or compensation[203]. But in the last few years membership to the Convention has grown considerably, since all Central and East European States, including Russia and the Ukraine[204], joined it and its mechanism of judicial implementation. This development is taking place together with a vast boom of foreign direct investment in the Eastern parts of Europe and might increase the impact of regional human rights treaties, in particular the European Convention upon the protection of foreign direct investment.

2. The American Convention on Human Rights

The Inter-American system of human rights protection comprises thirty-four countries with a population of more than 600 million and is represented by the Organization of American States (OAS). The economical development and the distribution of wealth vary widely in this area[205]. The protection of human rights is based on a dual institutional structure, one having evolved from the Charter of the Organization of American States in 1948 and the other established by the entry into force of the 1969 American Convention on Human Rights in 1978[206]. Two independent organs safeguard implementation of the American Convention: In 1959 a Commission was set to serve as a mechanism for the protection of human rights, the Inter-American Commission of Human Rights. The Commission is vested with the authority to deal with allegations concerning a violation of human rights contained in either the American Declarations of the Rights and Duties of Man of 1948 or the 1969 American Human Rights Convention. The competence of the Commission was initially limited to give recommendations "with the objective to bring about more effective observance of Human Rights". In 1978 the American Convention on Human Rights came into force and incorporated the Commission. Moreover, it provided for the establishment of the Inter-American Court on Human Rights. The protection system under the American Convention still resembles the one previously applicable under the European Convention: Only a state concerned or the Commission can submit a case to the Court, provided, moreover, that the state concerned has accepted the Court's jurisdiction. The Court's judgments are binding, but without an enforcement mechanism comparable to the European system. Also in contrast to the European system, the OAS inter-state complaint mechanism is optional whereas the accep-

203 *Weber*, Menschenrechte (2004), p. 819.

204 *Waelde/Gunderson*, Legislative Reform in Transition Economics: Western Transplants – A short-cut to Social Market Economy Status?, International and Comparative Legal Quarterly, vol. 43 (1994), p. 347 *et seq*.

205 *Reisman*, Practical Matters for Consideration in the Establishment of a Regional Human Rights Mechanism: Lessons from the Inter-American Experience, St. Louis Warsaw Trans'l 89 (1995), p. 90-92.

206 American Convention on Human Rights, 22 November 1969, in force 18 July 1978, OEA/ser.L/V/II.23, doc. 21 rev. 6 (1979), O.A.S.T.S. No. 36 at 1.

tance of the individual petition procedure is mandatory for any State Party to the Convention[207].

The instrument preceding this Convention, the American Declaration on the Rights and Duties of Man[208], provided for property protection[209], adhered to the approach to the right of property as a human right and set a rule for compensation in case of expropriation[210]. The American Convention on Human Rights of 1969 contains rules for the protection of property in its Article 21[211] and according to Articles 24 and 25 the right to equal protection and the right to judicial protection. Article 44 states that juridical persons do not have the capacity to lodge petitions to the Commission[212]. In deciding not to entertain these kinds of petitions, the Commission is excluding a major part of the economic disputes potentially arising under the American Convention. Notwithstanding, a significant case in the context of foreign property protection is the case *Mevopal S. A.* v. Argentina[213]. *Mevopal S. A.*, a construction company, entered into three construction contracts with the Provincial Housing Institute in the Province of Buenos Aires. The contracts were breached in various respects and caused a loss of working capital for *Mevopal*. The company then filed various local suits, but the Argentine Supreme Court rejected the appeals filed. On behalf of *Mevopal* its legal representative filed a petition with the Inter-American Commission on Human Rights alleging *inter alia* the violation of property by the State of Argentina. The Commission found that it was lacking competence *ratione personae*, inasmuch as juridicial persons are not entitled to protection by the Convention and declared the petition inadmissible. Although the awards rendered by the

207 All states ratifying the convention accept the right of any person or group of persons, or any non-governmental entity legally recognized in one or more member states of the OAS to present petitions to the inter-American Commission, see Art. 44 of the American Convention on Human Rights.

208 The Declaration was accepted by the Ninth International Conference of the American States in 1948 in Bogota and is available at <http://www.oas.org/juridico/english/Treaties/b-32.htm>.

209 See Article XXIII: „Every person has a right to own such private property as meets the essential needs of decent living and helps to maintain the dignity of the individual and of the home."

210 „The States shall guarantee the right to private property, and its individual or collective use shall be subject to the interests of society, with respect at all times for the dignity of the individual and the inherent needs of family life. Expropriation shall be legal in cases of public utility or social interest, in which case compensation shall be made."

211 The Article states that "(1) everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interests of society. (2) No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law. (3) Usury and other forms of exploitation of man and by man shall be prohibited by law," see Inter-American Commission on Human Rights, Ten Years of Activity 1971-1981 (1982) 28.

212 Article 44 states that „any person or group of persons, or any nongovernmental entity legally recognized in one or more member states of the Organization, may lodge petitions with the Commission containing denunciations or complaints of violation of this Convention by a State Party."

213 Case *Mevopal, S.A. v. Argentina*, Report No. 39/99, Inter-Am. C.H.R. OEA/Ser. L./V./II.95 doc. 7 rev. 297 (1998).

Commission of the Convention entitle the claimant for compensation[214], it has little practical relevance in the field of foreign investment.

3. The African Charter on Human and People's Rights

The African Charter on Human and Peoples' Rights[215] was the last regional human right Convention entering into force[216]. It obliges its contracting parties to recognize the rights, duties and freedoms contained in the Charter and bring them to full effect by adopting the legislative or other measures required[217]. The Charter functions within the framework of the African Union (AU). It emphasizes African traditions and values, but also grants peoples' rights as well as individual rights, particularly referring to the right of development. Moreover, the Banjul Charter proclaims economic, social, cultural as well as civil and political rights. It protects private property as such[218], but not the owner. It reflects the specific attitude of the developing countries towards the right and protection of property as a fundamental right[219], but it determines no legal consequences in case of expropriation[220] and can therefore not provide a sufficient protection of property.

Pursuant to Article 30 of the Charter the African Commission on Human and People's Rights was founded which duties are to promote human and peoples' rights and ensure their protection in Africa[221]. The Commission consists of eleven independent members and has four functions explicitly conferred to it under the Charter: the promotion of human and peoples' rights in Africa, the protection of those rights and the interpretation of the Charter. The Commission is deemed to still explore the scope of its powers due to the short time of its being in function, but by the end of its

214 See Art. 68 (3) American Convention on Human Rights.

215 The Convention is originally called the *Banjul*-Charter, see African Charter on Human and People's Rights, adopted 27 June 1981, entered into force 21 October 1986, O.A.U. Doc. CAB/LEG/687/3 rev. 5, reprinted in (1982) 21 I.L.M. 58.

216 *Shelton*, Remedies in International Law (2005), p. 113; *Mugwanya*, Realizing universal human rights norms trough regional human rights mechanisms: reinvigorating the African System, Indiana International & Comparative Law Review, vol. 10, No. 1 (1999), p. 35-50.

217 See generally *Essien*, The African Commission on Human and People's Rights: Eleven Years After, 6 State University of New York at Buffalo School of Law Review 93 (2000), p. 93-111.

218 See Article 14 stating that „The right to property shall be guaranteed. It may only be encroached upon in the interest of public need or in the general interest of the community and in accordance with the provisions of appropriate laws."

219 *Dolzer*, Eigentum, Entschädigung und Enteignung im geltenden Völkerrecht (1985), p. 106.

220 See Article 14 (2) African Charter on Human Rights.

221 Before the adoption of the Protocol to the African Charter on Human and Peoples' Rights on the establishment of an African Court on Human and Peoples' Rights on 1 January 2004, the protection of rights listed in the *Banjul*-Charter was exercised solely by the African Commission on Human Rights, a quasi-judicial body, modelled on the United Nations Human Rights Commission with no power to adopt binding measures. The Commission's functions are limited to examine state reports or to interpret the Charter on request of a state party.

first decade it had concluded over 100 cases[222]. To make the African system for the protection of human rights more effective, a new mechanism was taken on in 1998[223]. The Protocol to the African Charter on Human and Peoples' Rights on the establishment of an African Court on Human and Peoples' Rights entered into force on 25. January 2004 upon its ratification by fifteen Member states[224] and resulted in the establishment of the African Court on Human and Peoples' Rights (ACHPR)[225]. It provides that the Court accepts actions on the basis of any instrument, including human right treaties, which have been ratified by state parties in question[226]. Individuals as well as NGO's may submit actions to the Court[227]. Moreover, the Court can apply as legal source of law any relevant human rights instrument ratified by the respective state[228]. While its judges have been recently elected, the permanent seat of the Court still has to be determined and its statute to be adopted in order to make it functionable[229].

222 See http://www.achpr.org/english/_doc_target/documentation.html?../activity_reports/activity-16_en.pdf>; *Quashigah,* The African Charter on Human and People's Rights, African Human Rights Law Journal, vol. 2, No. 2 (2002), p. 261-300.

223 *Ibid*.; *Nmehielle*, Towards an African Court of Human Rights: Structuring and the Court, 6 Annual Survey of International and Comparative Law 27 (2000), pp. 27 (29); *Udombana*, Toward the African Court on Human and Peoples' Rights: Better late than never, 3 Yale Human Rights and Development Journal (2000) 45; *El-Obaid/Kwadwo*, Human Rights in Africa – A New Perspective on Linking the Past to the Present, 41 McGill Law Journal (1996) 819; *Akinseye-George*, New Trends in African Human Rights Law: Prospects of an African Court of Human Rights, University of Miami International and Comparative Law, Vol. 10 (2001/2002), p. 159 (175)*; Krisch*, The Establishment of an African Court on Human and People's Rights, Zeitschrift für ausländisches öffentliches Recht und Völkerrecht, vol. 58 (1998), p. 713(733).

224 See <http://www.achpr.org/english/_doc_target/documentation.html?../ratifications/ratification_court_en.pdf>; *Wundeh Eno*, The Jurisdiction of the African Court on Human and Peoples' Rights, African Human Rights Law Journal (2002), p. 223-233; *Mubangisi*, An African Court on Human and People's Rights, South-African Yearbook of International Law (1999), pp. 256.

225 The Court should eventually be merged with the envisaged African Court of Justice the Charter of which has, however, not yet come into force; see further *Udombana*, An African Human Rights Court and African Union Court: A needful Duality or a needless Duplication?, Brooklyn Journal of International Law, vol. 28, No. 3 (2003), pp. 811.

226 See Art. 3. 1. of the Protocol.

227 See Occasional Paper, The African Court on Human and Peoples' Rights – Presentation , analysis and commentary: the Protocol of the African Charter on Human and Peoples' Rights, establishing the Court (2000), IA; further *Mohamed*, Individual and NGO Participation in Human Rights Litigation before the African Court of Human and People's Rights: Lessons from the European and Inter-American Courts of Human Rights, Journal of African Law 377(1999), p. 201-213; generally *Welch*, Protecting Human Rights in Africa: Strategies and Roles of Non-Governmental Organizations, University of Philadelphia Press (1995), pp. 279.

228 Art. 7 of the Protocol.

229 See <http://www.achpr.org/english/_doc_target/documentation.html?../activity_reports/activity1 6_en.pdf>.

III. Summary

The above considerations permit a brief evaluation of the role of human rights institutions in the context of foreign investment protection. While the traditional or classical concept of diplomatic protection in the sense of inter-state remedy has dominated the area of human rights protection until World War II, the new generation of treaties granting human rights to the individual has challenged this approach and improved the standing of individuals in international human rights litigation significantly. For instance, the ECHR and the African Court on Human and Peoples' Rights allow individuals to lodge claims against states who have expressly recognized the competence of the tribunals. The African Court on Human and Peoples' Rights also acknowledges human rights treaties concluded under the auspices of the United Nations as admissible sources of law; given the respective state is party to the treaty. The admissible application of the individual under the ECHR and the African Convention on Human and Peoples' Rights marks a great departure taken by these conventions from traditional forms of the international protection of individuals for they dispense with nationality as a condition of protection. Thus the developments in international human rights law show that the conceptual understanding of the rule of diplomatic protection had to face the winds of change resulting in a human rights protection system which is based on treaty law and limited to the means provided by the particular treaty. In sum, the principal achievement of contemporary human rights protection is to grant the same protection to all individuals regardless of their nationality or other factors, which can be pursued procedurally.

But there are two sides of the coin. Like all international law, human rights law is the law of the political system of nation states and subject to international political forces. The rights granted to the individuals by the respective treaties are not entirely covered by corresponding procedural rights in international law and it is not at all certain that the state parties intend to accept any international decision making and enforcement procedures for the protection of individual rights other than the ones provided for in the respective treaties. This is no coincidence but rather mirrors the underlying structural flaws of international law in general, which are to determine the amount of reparation to be paid to meet the requirements of an "adequate compensation" in each given case. Receiving an appropriate reparation payment in case of deprivation of property is a major factor to safeguard investment, in particular in a foreign country. Invoking a tribunal under the ICSID Convention provides these safeguards by a consistent and coherent jurisprudence rendered by experts as well as by binding awards. Its structural framework is tailor-made to meet these specific requirements and can therefore afford legal certainty by rendering consistent jurisprudence. The idea of the ICSID Convention at first line is to safeguard foreign property by providing a procedural framework in case of disputes, while human rights aim at the detachment of the individual from the state and a civilized conduct among states, including a non-discriminatory protection of property. Although, therefore, both concepts had the same basic purpose, namely the protection of the person and his property, they appear both in theory and in past practice as mutually

divergent. Ultimately, the exhaustion of local remedies remains a prerequisite for the application of diplomatic protection, which might be very time consuming and hinder alien investors from invoking human rights tribunals given that the ICISD Convention is ratified by the respective state. Otherwise international and in particular regional human rights courts might represent the last legal resort for the investor. An institutionalisation of the right of unilateral recourse to a remedy such as ICSID in treaties creating investment protection regimes represents a new approach to jurisdiction absent the local remedies rule and caters to the interests of foreign investors. If the system established under ICSID can overcome its current state of crisis, international human rights courts will not draw up level with tribunals under the ICSID Convention in the field of foreign investment protection.

D. The Role of the World Trade Organization

The following section examines the approach of the World Trade Organization (WTO) to foreign investment in order to draw conclusions on its current role as well as on its potential future prospects. Taking in account the close linkage between trade and investment, the WTO seems to be the appropriate venue for international investment protection, yet investment is the "missing panel" in the WTO's body of trade and trade-related agreements. Consequently, drafting a multilateral agreement on foreign investment protection under the auspices of the WTO has been on the agenda since the end of the twentieth century, when in the mid-1990s the Uruguay Round introduced an investment dimension in multilateral trade rules, bringing about new implications for foreign investment[230]. Notwithstanding this situation it is important to note that investment is, however, to some extent already covered by the WTO system, yet in a fragmented manner and dotted across a range of agreements. Foreign investment-related issues in that sense can now be found in five WTO agreements: the *General Agreement on Trade in Services* (GATS), the *Agreement on Trade-Related Investment Measures* (TRIMs), the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs), the *Agreement on Government Procurement* (GPA) and the *Agreement on Subsidies and Countervailing Measures* (ASCM)[231]. A single multilateral investment agreement on a comprehensive basis might be a clearly better approach, since the plethora of diverse bilateral and plurilateral agreements addressing foreign investment issues appears as a tangled web of competing and even conflicting commitments and potentially impairs foreign investment. Yet, significant objections were raised against the drafting of such a multi-

230 OECD, Working Papers on International Investment (2004), Relationship between International Investment Agreements, p. 3.

231 The ASCM is dealing with the prohibition of subsidies contingent upon domestic over foreign procurement and export performances. This has implications for access to investment incentives conditioned on performance requirements.

lateral agreement and none of the proposals made in this respect could successfully be implemented. Opposition against the idea of a multilateral comprehensive agreement within the WTO system was voiced mainly by developing countries which demanded, as a minimum, the introduction of exceptions, special treatment and escape clauses. It is true that investment law and trade law overlap substantially, but as they are heading at different achievements, introducing an investment agreement into the WTO system may be of debatable merit. To illustrate the circumstances surrounding the negotiations and drafting process of such a multilateral framework on foreign investment in the WTO, the development of the issue will be briefly described with an emphasis on the conflict provoking aspects of the drafting of a multilateral comprehensive investment agreement.

I. History

A glance at the history and the development of the WTO elucidates the background of the current situation: The Havana Charter in its version of 1947/1948, made for the International Trade Organization (ITO)[232], which was planned to come into effect along with other international institutions in this period of time, contained some provisions on foreign investment. Two articles of the Charter dealt with the issue of foreign direct investment and its protection[233]. One of these provisions was considered to give a preference to the developed states and was therefore severely objected to by the developing states. Ultimately, the Charter never came into force[234] and the ITO was whittled down to the provisions of the General Agreement on Tariffs and Trade (GATT)[235]. They contained rules on trade in goods and dealt with investment only peripherally. This setting was the initial situation for the separate development of international trade and investment in the system of the WTO.

During the Uruguay Round the issue of foreign investment was taken into consideration again and efforts were made to agree on measures regarding investment in international trade[236]. However, the Uruguay Round negotiations on trade-related investment measures were marked by strong disagreement among participants over

232 United Nations Conference on Trade and Employment, UNYB 1947-1948, 522 *et seq*.

233 Article 11 provided that no member "shall take unreasonable or unjustifiable action" against investment and determined "fair and equitable" treatment. Article 12 entitled the members to take appropriate safety valves against foreign investment and to "determine whether and to what extent and upon what terms it will allow future foreign investment".

234 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 136 (137).

235 Dated 30 October 1947, in the version valid since 1 March 1969, UNTS 55, 94.

236 Ministerial Declaration of Punta del Este; see *Senti*, WTO – Regulation of World Trade after the Uruguay Round (1998), para 1143; *Shenkin*, Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT, Moving toward a multilateral investment treaty, University of Pittsburgh Law Review, vol. 55, No. 2 (1994), pp. 541; *Mashayeki/Gibbs*, Lessons from the Uruguay Round Negotiations on Investment, Journal of World Trade, vol. 33 (1999), pp. 1 (26).

the coverage and nature of possible new disciplines[237] and proved to be highly frustrating;[238] finally, the implementation of the TRIMS-Agreement was due to the decreasing interest of the U.S.A. on extensive investment liberalisation[239]. At the Ministerial Summit in Singapore in 1996 the WTO received the mandate to establish a "Working Group on Trade and Investment (WGTI)"[240]. The committee was to evaluate the feasibility of drafting a comprehensive regime on investment that could be administered by the WTO. Within the WGTI several aspects raised by the members of the Working Group were discussed during the first sessions. This check list of trade and investment contained the issues of the implications of the linkage between trade and investment for development and economic growth, in particular the economic parameters relating to macroeconomic stability, the degree of correlation between trade and investment flows and the determinants between this relationship as well as a stocktaking exercise regarding existing WTO provisions and implications for trade and investment flows of existing international instruments. The mandate was then renewed and specified at the Ministerial Summit in Doha in 2001[241]. The Doha Declaration announced commitment to the continuation of the WGTI and instructed the group to consider and clarify diverse issues, but is does not commit the WTO to formally launch comprehensive negotiations on a "General Agreement

237 Some developed countries made proposals for regulations that would prohibit a wide range of measures in addition to the local content requirements, which were found to be inconsistent with Article III in the *FIRA* panel case. Many developing countries raised objections and heavily opposed this approach.

238 *Croome*, Reshaping the World Trading System – a history of the Uruguay Round (1999), p. 116; <http://www.wto.int/english/thewto_e/whatis_e/eol/e/wto05/wto0f_3.htm#note4>.

239 The GATT rules only extend to a relatively narrow range of investment measures with direct and immediately identifiable impacts on trade. In the Uruguay Round of GATT negotiations, the United States in particular favoured a much more comprehensive GATT code on investment based upon the principle of free access to foreign markets. Unlike the United States, most other Contracting States were sceptical of the free access approach, and saw the task of the Uruguay Round negotiations on investment as that of developing more detailed and explicit rules with respect to measures that appear inconsistent with well-established GATT-principles, such as national treatment with respect to products, which would also require an extension of the kind of analysis to a broader set of measures such as trade balancing requirements or export performance requirements that directly affect trade flows.

240 *Stoll*, The World Trade Organization (WTO), in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. IV (1999), p. 1541; *Gallagher*, Guide to the WTO and Developing Countries (2000), p. 67; for a later stage see generally *Correa/Kumar*, Protecting Foreign Investment, Implications of a WTO regime and policy options, (2003), p. 35 (50); a general survey is provided by *Sauve*, Qs and As on trade, investment and the WTO, Journal of World Trade, vol. 31, No. 4 (1997), p. 55 (79).

241 The Doha-Ministerial Declaration, 14. November 2001, WT/MIN(01)/DEC/1.

on Investment"[242]. In addition, the development issue was levelled into play and, in accordance with the Doha mandate the needs of the poorer states were to be taken into account within the considerations of the WGTI[243].

At Cancún in 2003, the EC's insistence on the launching of investment negotiations and the adamant stance of a large group of developing countries that investment should be put on hold were a major factor[244]. With neither the USA nor the EC prepared to support negotiations in the face of the developing countries resistance, investment is effectively off the table at the WTO for a foreseeable future, which is clearly reflected in the results of the Ministerial Summit in Hong Kong in December 2005[245].

II. The WTO Agreements

Currently, the five agreements mentioned above address issues of foreign investment in their provisions. This section introduces three of them: the *General Agreement on Trade in Services* (GATS), the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs) and the *Agreement on Trade Related Investment Measures* (TRIMs). The regimes appear to be not entirely compatible, as the GATS seeks to provide market access by its non-discrimination rules, addressing primarily macroeconomic issues, while the TRIPs focuses on the microeconomic aspects of foreign direct investment[246] and the TRIMs aims at prohibiting measures of WTO member states making the approval of investment conditional on compliance with any regulations that favour domestic products. This section explores the agreements and provides a short analysis and evaluation.

242 These issues were *inter alia* scope and definition; transparency; non-discrimination; modalities for pre-establishment based on GATS-type positive list approach; development provisions; exceptions and balance of payments safeguards; and consultation and the settlement of disputes; for an evaluation see *Kurtz*, A general investment agreement in the WTO – Lessons from Chapter 11 of the NAFTA and the OECD Multilateral Agreement on Investment, Jean Monnet Working Paper (2002), pp. 48; see also *Kentin*, Prospects for rules on investment in the new WTO round, Legal issues for economic integration (2002), p. 61 (77).

243 Some states contributing to the work of the WGTI claimed that a comprehensive multilateral instrument should be based on the General Agreement on Trade in Services (GATS), see also WTO Secretariat, Modalities for Pre-Establishment – Commitments based on a GATS-Type, Positive List Approach (WT/WGTI/W/120), 19 June 2002.

244 Generally *Mosoti*, Bilateral Investment Treaties and the possibility of a multilateral framework on investment at the WTO – are poor economics caught in between?, North-western Journal of International Law (2005), p. 95-138; *Davenport*, Investment incentives in commonwealth developed countries and the WTO investment negotiations, (2003).

245 WTO-Doc. of the Ministerial Conference, 13-18 December 2005 in Hong Kong, WT/MIN (05)/DEC.

246 See *Vandevelde*, The Economics of Bilateral Investment Treaties, Harvard International Law Journal, Vol. 41, No. 2 (2000), pp. 469.

1. The Agreement on Trade-Related Investment Measures (TRIMs)

The Uruguay Round Final Act reflects a subtle compromise[247] between varying perspectives of the negotiating parties: the TRIMs Agreement[248], which contains new disciplines for investment measures, aims at safeguarding investment benefits for national economy and development[249]. The main purpose of the agreement is to prohibit discrimination between imported and domestic goods. It applies to investment measures related to trade in goods, but not to general issues in the field and prohibits certain of these measures.[250] As the TRIMs is no comprehensive agreement and partly linked to the GATT, the respective measures need to be consistent with the national treatment obligations of the GATT[251] according to Article III[252] and XI[253] of GATT 94 as foreseen in Article 2 TRIMs[254]. An illustrative list[255] has been attached to the TRIMs listing examples of potential measures considered inconsis-

247 The compromise eventually reached during the negotiations is essentially limited to an interpretation and clarification of the application to trade-related investment measures of GATT provisions on national treatment for imported goods (Article III) and on quantitative restrictions on imports or exports (Article XI).

248 Final Act Embodying the Results of the Uruguay Round of multilateral Trade Negotiations (MTN/FA), Geneva, 15 December 1993, II. 7 "Agreement on Trade-Related Investment Measures", which came into effect on 1 January 1995; thus, the TRIMs Agreement does not cover many of the measures that were discussed in the Uruguay Round negotiations, such as export performance and transfer of technology requirements.

249 These measures are inter alia local content, local manufacturing requirements, trade balance targets, production mandates, foreign exchange restrictions, mandatory technology transfer requirements and equity restrictions.

250 *Rai*, Trade Related Investment Measures under the WTO, The Indian Journal of International Law, vol. 41, No. 3 (2001), p. 435-477; OECD Working Paper, Working Paper on International Investment, Relationship between International Investment Agreements, p. 7.

251 This concerns the treatment of imported goods versus domestic goods.

252 National Treatment.

253 See Article 1 TRIMs: Prohibition on quotas and other measures prohibiting or restricting the importation, exportation or sale for export of any product, except for duties, taxes or other charges.

254 See Panel WT/DS4/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para 14.61.

255 The list is non-exhaustive but provides a very concise definition of the respective measures including local content, sourcing and some trade-balancing requirements, which violate national treatment, and import and export restrictions, which violate the ban on quantitative restrictions, see Article XI of the GATT. In the case discussed below the panel stated moreover that "[A]n examination of whether the measures (in question) are covered by Item (1) of the Illustrative List … will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 GATT and thus in violation of Article 2.1 of the TRIMS Agreement, see Panel Report, *Indonesia-Certain Measures Affecting the Automobile Industry*, para 14.83.

tent with Article III:4 or Article XI:1 of the GATT 94[256]. In addition, the TRIMs provides for a transition period[257], during which properly notified measures are not regarded inconsistent with GATT 94[258]. By now, however, all non-conforming measures should have been eliminated, but a number of waivers have been granted to some states[259].

In spite of the cautious approach of the TRIMs to comprehensive investment provisions, the WTO panels were invoked to decide on conflicts based on an interpretation of TRIMs provisions. Yet, it was considerably notable that the panels largely attempted to avoid considering claims under the TRIMs by choosing to consider the related claims of violation of national treatment prior to examine alleged violations of TRIMs. Nevertheless, one of the first cases where the issue of foreign investment was brought on the table by a panel was the Case *Indonesia- Certain Measures Affecting the Automobile Industry*[260]. Pursuant to an *Indonesian Car Programme* tax benefits were linked to domestic content requirements applicably solely to cars produced and manufactured in Indonesia. In addition, custom duty benefits for imported components for cars were also linked to similar domestic content requirements. The panel regarded these local content requirements as *investment measures* because they had a significant impact on investment in the automotive sector[261] and considered them *trade-related* because they affected trade[262]. As a result, the *Indonesian car programme* providing for local content requirements was considered a breach of

256 The Annex shall "provide additional guidance as to the identification of certain measures considered to be inconsistent with GATT Article III: 4 and XI: 1 of the GATT 1994". Panel Report, *India-Auto Sector*, para 7.157. The *India-Auto Sector* Case involved a TRIM requiring "trade balancing". Domestic auto manufactures were allowed to import components and parts conditioned on a certain FOB (free on board) value of exports of cars and components over the same period. The panel addressed this measure considering it a restriction, contrary to the terms of Article XI: 1 (paras 7.277-7.278). After finding the trade balancing requirements violate GATT Article X: 1, the *India-Auto Sector* panel invoked the principle of judicial economy and concluded that it was not necessary to analyse the measures under the TRIMS Agreement.

257 In accordance with Article 5.2-5; moreover, Article 5:4 contains a "*stand-still*" obligation, see *Senti*, WTO – Regulation of World trade after the Uruguay Round (1998), para 1147; *Stoll*, WTO-Handbuch – Welthandelsordnung und Welthandelsrecht (2006), Chapter C.I.6, para 24.

258 In this respect, the TRIMS Agreement is a "*one-stop shop*".

259 In particular Columbia and Thailand benefit from a waiver. The measures in question were to be lifted by the end of 2003 at the latest.

260 Panel Report*, Indonesia - Certain Measures Affecting the Automobile Industry,* WT/DS54/R, WT/DS55/R, WT/DS59/R, paras 14.97-14, 99; *Falke*, Vertragskonkurrenz und Vertragskonflikt im Recht der WTO: Erste Erfahrungen der Rechtsprechung 1995-1999, ZEuS 2000, 307.

261 *Id.* para 14.80.

262 *Id.* para 14.82; The panel also held that compliance with the requirements for the purchase and use of products of domestic origin was necessary to obtain the tax and customs duty benefits and those benefits were advantages within the meaning of the Illustrative List, see *ibid* paras 14.89-14.91.

the TRIMS Agreement[263]. Another panel decision dealing with a potential violation of TRIMs obligations was the *India-Auto* Case[264], where the panel found a breach of the national treatment obligation[265]. The panel followed the common strategy to avoid addressing a potential breach of TRIMs obligations directly and thus considered the allegations regarding the TRIMs solely on the basis of *judicial economy*[266]. Referring to the case, the panel stated that "the TRIMs Agreement might not be considered more specific than the GATT Article III:4", which seems peculiar, as the TRIMS, only applicable to a specified subset of investment measures, appears to be an elaboration of Article III:4 GATT 94[267].

Perhaps the most significant development with respect to investment was a ruling by a panel in a dispute settlement proceeding between the United States and Canada: the *FIRA Panel* Decision[268]. The decision is the only case concerning foreign investment measures directly as a GATT dispute settlement panel considered a complaint by the United States regarding specific types of undertakings which were required from foreign investors by the Canadian authorities as conditions for the approval of investment projects. At issue was the "Canadian Foreign Investment Review Act", which established a governmental agency, the Foreign Investment Agency. The Agency's task was to evaluate investment applications submitted by

263 *Id.* para 14.91; Therefore any measure affecting investment matters should be regarded as an investment measure falling within the scope of the TRIMS Agreement, see Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para 14.80: "On the basis of our reading of these measures which have investment objectives and investment features and which refer to investment programmes, we find that these measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia."

264 *India-Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R (21 December 2001).

265 *India-Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R (21 December 2001).

266 Paras 7.151-7.161; the respective approach seems to be based to some extent on the considerably superficial discussion of TRIMs in the early Bananas Case, see *EC-Bananas III*, Report of the Panel, para 7.186, where the Panel, however, considered the claims simultaneously; in the Canada-Auto dispute [*Canada-Certain Measures Affecting the Automotive Industry*, WT/DS139/R (11 February 2000)], the Panel ruled moreover that the particular measure in question did not result in a breach of the national treatment Article III:4 of GATT, and therefore there could be no violation of the TRIMs Agreement, see para 10.150.

267 In the *Canada-Autos* dispute (WT/DS139/R), the panel rejected an argument by Canada concluding that a different aspect of its policies did not bring about a breach of Article III: 4 since the questionable measure was not listed in the TRIMs illustrative list of investment measures. Referring thereto the panel stated that since the list was non-exhaustive, the fact that a particular measure was not on the list expressed nothing in itself about whether the measure could be a national treatment violation, at para 10.89; the assumption that it is appropriate to consider a claim of national treatment violation prior to a claim of TRIMs violation appears at odds with the view of the Appellate Body in the *Sardines* case that claims under an agreement considered as *lex specialis* ought to be considered prior to those under the more general norms like national treatment; this view is also found in the early Appellate Body ruling in *Bananas*.

268 *Canada Administration of the Foreign Investment Review Act* (FIRA), BISD 30S/140 (1984).

foreign investors. Applications were followed when investment could carry out a significant benefit for the country itself focusing on the advancement of national industrial and economic policies. The purchase of certain products from domestic sources were determined as well as the export of a certain amount or percentage of output in the sense of an export performance requirement. The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations[269]. The panel decision in the *FIRA* case was significant in that it confirmed that existing obligations under the GATT were applicable to performance requirements imposed by governments in an investment context in so far as such requirements involve trade-distorting measures. But summarizing the impact of the TRIMs, it appears that it merely emphasizes the validity of rules already in force under the GATT and does therefore not carry much of development on foreign investment protection.

2. The General Agreement on Trade in Services (GATS)

As services are not covered by the GATT but play a significant role in contemporary international trade, the WTO system required the adoption of a new, separate and comprehensive agreement concerning trade in services. The *General Agreement on Trade in Services* (GATS) has partly been modelled on the GATT and mirrors its structure widely. Of all WTO agreements, the GATS addresses investment issues most directly[270]. In parallel to the GATT, some GATS provisions provide for most favoured nation (MFN) standards[271] and national treatment[272].

In accordance with the MFN obligation, service suppliers from one member state must not be treated in a less favourable way than like services and service providers from any other member state which is regarded as an "immediate" and "unconditional" obligation[273]. National treatment, however, applies only to scheduled sectors. The GATS aims at liberalization in trade in services and contains therefore provisions concerning general obligations and disciplines and provisions concerning additional standards applicable in liberalized sectors. The GATS provisions do not

269 Canada Administration of the Foreign Investment Review Act (FIRA), BISD 30S/140 (1984), *ibid.*

270 OECD Working Paper, Working Papers on International Investment, Relationships between International Investment Agreements (2004), p. 6.

271 See Article II GATS.

272 See Article XVII GATS.

273 Part II: "General Obligations and Disciplines", Article II Most-Favoured-Nation Treatment, paragraph 1 reads: "with respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and services suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country".

deal with investment directly, but the issue is being dealt with through the term of a "commercial presence mode of supply", which is in essence an investment activity. Commercial presence in the sense of the provisions requires the establishment of commercial presence in the country where the service is supplied, which is therefore, in fact, a mechanism to provide market access[274]. Due to its inherent flexibility the GATS was considered to serve as a role model for the comprehensive multilateral agreement and thus simply to extend the GATS style approach[275]. But the suggested GATS style approach to liberalization holds various weaknesses: the level of liberalization might place constant pressure on certain countries to open sectors for liberalization and under the GATS countries are subject to uncertain terms for GATS rules are only poorly defined. Finally, negotiations under the GATS are bilateral, while a substantive agreement would bind multilaterally and create obligations in that sense.

3. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)

The *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs) was initiated to address the growing importance of intellectual property rights and is therefore heading at adequately protecting intellectual property rights. The agreement is building upon existing intellectual property conventions[276] and provides for both, national treatment and MFN for the protection of specific sectors[277]. It contains three different sets of provisions, but none addresses issues of investment[278]. Yet, it helps to open up economies to foreign investment by protecting technology which

274 The WTO members can impose restrictions with respect to the commercial presence through e.g. a limitation of the number of economic operators (Article XVI GATS) or take exceptions from MFN to foreign services suppliers or from the obligation to accord national treatment (Article II:2 and Article XVII GATS).

275 As a consequence, this would mean the subjection of sectors to liberalization, while other exceptions and qualifications would be maintained.

276 Such conventions include the 1971 Berne Convention for the Protection of Literary and Artistic Works, the 1967 Paris Convention for the Protection of Industrial Property, the 1961 Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations, 1961, and the 1989 Washington Convention on Intellectual Property in respect of Integrated Circuits.

277 Such as copyright, patents, trademarks, etc.

278 The different sets of provisions are (1) institutional arrangements and procedures to deal with intellectual property matters within the WTO system, (2) substantive standards relating to intellectual property rights and (3) standards for enforcement of such rights.

plays an important role for investment abroad[279]. In addition, the TRIPs provides standards of protection which are also comprised by the scope of investment in regional and bilateral investment treaties. The respective rights are created in domestic law and apply within these legal systems, as the TRIPs determines standards that are supposed to be transformed into national law. Holders of these rights are entitled to benefit from certain standards with respect to the domestic enforcement structures and their rights in terms of access to judicial remedies[280]. A breach of such standards does not imply a failure to an obligation resulting out of an international treaty, but has to be addressed in national and domestic law[281].

III. Summary

Adding investment to the WTO agenda clearly goes beyond the traditional notion of trade and thus indicates an inclination to broaden the scope of the WTO system in order to comprise general commercial issues as well. Negotiations on a "General Agreement on Investment", however, have an advantage as compared with other *fora* because of their capacity for trade-offs with other fields, such as intellectual property and trade in services. But it also sparked a contentious and complex debate within the system and the approach of the WTO system to draft a multilateral comprehensive regime on foreign investment has been challenged consistently. The recent history of the WTO may explain some of the circumstances, but in this context the question must be raised as to the benefits which would result from the drafting of a multilateral comprehensive agreement by the WTO. The attempts to negotiate such an instrument failed, however, and have been struck off the agenda since. At the present period the drafting of such a regime is being put on hold. Still, various benefits of such multilateral agreement could be asserted: A comprehensive investment agreement would provide for both, greater transparency and well-defined investor rights, and could thereby bring order to international investment law. Trade and investment are connected by a close linkage, which would be reflected in a comprehensive multilateral investment agreement drafted by the WTO. Ultimately, a substantive multilateral investment agreement may increase investment flows, in particular to developing countries.

279 See *Burt*, Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization, 12 Am.U. Int'l L. Rev. 1015, 1039 (1997), stating that "[t]he transfers of technology accompany the great majority of foreign investment from multinational corporations in home countries to their subsidiaries in host countries" and the protection of technology "[r]emoves another source of insecurity for foreign investors and promotes the transfer of technology between countries, in particular between developed and developing countries", *ibid.* at 1039.

280 OECD Working Paper, Working Papers on International Investment, Relationships between International Investment Agreements (2004), p. 7.

281 Conversely, investment treaties create such international obligations.

But the approach of the WTO to negotiate a comprehensive agreement on foreign investment also meets strong criticism, based on the idea of the different concepts and goals of international trade law and investment law. Including an agreement on foreign investment into the WTO system would require a basic equal concept of investment law and trade law. This is lacking. Despite the close linkage between trade and investment their diversity with regard to goals and achievements predominates. The WTO has its competence in trade issues and the principles governing trade are not suitable for investment[282]. In view of this situation, it can be stated that an investment agreement does not belong into the WTO system, because it simply might not be the right forum for a multilateral investment agreement. The factors stability, policy predictability and finally profit cannot be guaranteed by an investment agreement, but are of high importance for the success of investment abroad. In addition, there is no empirical proof that an investment agreement would promote foreign investment or increase investment flows. Another point of criticism is based on the fact that the mission of the WTO is of a fundamentally liberalizing character. This is a substantial objection to draft an instrument without such liberalization as its main object. Another weakness of the WTO system is its adherence to solely interstate remedies, which might be not as enforcement effective as the investor-state dispute resolution system under the ICSID.

The issues raised here mirror first and foremost the interests of an investor, and the question as to whether the WTO is the appropriate venue for an international investment agreement implies at first place the question where one is needed. From an investor's perspective, undertakings in certain developing countries bring about an immense risk with regard to potential rates of return and the WTO does not provide for the respective dispute settlement and enforcement processes. After all, it seems unlikely that negotiations on a comprehensive investment agreement will be able to proceed since there is no consensus on modalities, both procedural and substantive.

E. Conclusion

The roles of human rights institutions and the WTO in the context of foreign investment protection have been at issue in this paper and as a debate over the roles of these mechanisms in the context of foreign investment protection suggests, they, as mechanisms, seem only second choice when foreign investment litigation or arbitration is considered. Nevertheless, the coming period in ICSID jurisprudence is one in which the matter of consistency will be of utmost relevance. The challenge of the Argentine cases which are currently being dealt with extensively by the respective

282 In particular the application of non-discrimination and national treatment were inappropriate and would damage development. Moreover, a treaty of investors rights would be against the principle of reciprocity.

tribunals is indeed remarkable. The tribunals need to achieve a substantial degree of consistency - otherwise the ICSID might slide into a substantial crisis. Likewise, the alternative approach to foreign investment protection is given a special emphasis. The vast network of human rights conventions concluded on both regional and universal level provides for foreign property protection and non-discriminatory treatment of aliens. In particular in the regional human rights instruments, relatively effective human rights have been accorded to individuals irrespective of their nationality. As each member state can demand the respect of treaty obligations by the other member states, all are on an equal footing. Consequently, no state rights as such are encroached upon in case of a violation of such human rights held by any individual, but , a state party to a human rights convention can provide assistance to its national in order to secure his/her treaty rights. Thus the assistance is not different from any other state may provide. Given this assumption the rule of diplomatic protection in its classical conceptual inter-state understanding is not applicable. The state rather has to apply human rights assistance in the sense presented above, which is based on treaty law and limited to the means provided by the particular treaty. Ultimately, the prerequisites for diplomatic protection - especially the local remedies rule - and various legal limitations on the means of protection help to prevent an overly frequent use and abuses by powerful states.

Like any other mode the idea of investment protection by means of human rights institutions and human rights assistance is open to criticism. Obviously, the instrument of diplomatic protection and the concept of human rights assistance are founded on somewhat different bases and the expectation that the instrument of diplomatic protection would become superfluous through the new generation of human rights conventions has not been fulfilled. On the international plane, the individual has no equivalent corresponding procedural rights to achieve the respect of the substantive rights provided for in the human rights treaties. The ECHR might serve as an exception, since every member state acknowledged jurisdiction of the ECtHR. From the current perspective these treaties establish quite far reaching substantive rights for individuals but not as a corresponding basis for diplomatic protection by their home countries. This has proved to be ineffective due to failures in the institutional system of the respective treaty and the unwillingness of states to observe international treaty obligations. Yet, there is no general obligation for all states to submit their relevant disputes to a peaceful settlement through the binding decision of an independent and neutral authority. In particular in the field of foreign investment protection with its inherent underlying risks, there is a strong need for reliance on effective remedies and even more effective enforcement mechanisms.

One characteristic element of foreign investment law is that several concepts diverging with regard to their goal and nature are at clash at every moment. Foreign investment law and the protection of foreign investment are shaped by the goal of avoiding or at least reducing the element of risk for the investor in a long-term project. Safeguarding foreign investment undertakings is the core idea of the law on international investment protection, while human rights law as provided for by the new type of human rights treaties aims at the independence of the individual from

the state with regard to the protection of human rights. Instead, trade law focuses on liberalisation for the exchange of goods. International investment law needs to comprise elements of all of these concepts, and as with most clashes of legal concepts, there will be no complete triumph of any conceptual approach. This assessment is backed and mirrored by the current developments of international investment litigation. In the light of the preceding analysis the paper argues that foreign investment protection as provided for by the ICSID system is, in spite of its current crisis, not at all a bad outcome. The advantages of arbitrating under the auspices of the ICSID are manifold and it seems unlikely that the mechanisms offered by human rights institutions as well as the WTO can be considered as equal to ICSID. Each mechanism to protect foreign investment has to follow its own course in serving their task of foreign property protection, although sometimes their courses may run parallel.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Comment by *Sabine Konrad*[*]

A. Introduction

I would like to address two questions:

- Is the European Convention of Human Rights (the "ECHR" or the "Convention") an instrument of investment protection, and
- Is there something to be learned from the ECHR on the topic of the state's right to regulate as opposed the rights of the investor to protection?

B. The ECHR as an Instrument of Investment Protection

The ECHR is certainly not an instrument of investment protection in the formal sense.

However, the Convention has specific elements of investment protection in addition to the general protection of Human Rights of nationals and non-nationals alike. The case law of the Strasbourg court confirms this.

At a conference on "Stocktaking after 40 years" of ICSID, it is perhaps fitting to refer to a seminal case on the Convention's regime on expropriation which is 20 years old: *Lithgow vs UK*[1].

Article 1 of Protocol No 1 to the Convention contains the right to property and deals with expropriation.

Its relevant passage reads:

"No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."

The court held in *James vs UK*[2] and *Lithgow vs UK* that there are two different regimes, one for national and one for non-national investors. Whereas non-nationals are entitled to protection by the general principles of international law, including

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1 *Lithgow and Others v. the United Kingdom,* judgment of 8 July 1986, ECHR, Series A No. 102.

2 *James and Others v. the United Kingdom*, judgment of 21 February 1986, ECHR, Series A No. 98.

inter alia a right to compensation under the *Hull*-doctrine, nationals are not; for nationals, a right to compensation exists only as an emanation of the proportionality requirement. Thus only the regime for non-nationals is comparable to protection under a BIT.

Since most of its cases concern expropriation of the property of nationals, the case law of the European Court of Human Rights on expropriation has to be looked at with caution. Nonetheless it is possible to point to investment protection-type cases under the ECHR regime.

One example is *Sovtransavto Holding* vs Ukraine.[3]

This case concerns the rights of a Russian minority shareholder, *Sovtransavto*, in an Ukrainian public limited company, *Sovtransavto-Lugansk*. The management of *Sovtransavto-Lugansk* increased the shares of *Sovtransavto-Lugansk* thereby reducing the overall shareholding of Sovtransavto from 49% to just under 21%, in effect curtailing *Sovtransavto's* voting rights and taking control of the company. It further appears assets of *Sovtransavto-Lugansk* were sold to various entities set up by its managing director.

The investor challenged the actions of the management of *Sotransavto-Lugansk* in the national courts. The President of Ukraine in person interceded on behalf of the government in the court proceedings citing "national interests". This was done at the instigation of the management of the Ukrainian company, which by this time had become a private company. The investor lost his case and subsequent appeals. Ultimately *Sotransavto-Lugansk* was wound up and the investor received payments which "had not been in proportion to its initial 49% shareholding".

Had *Sovtransavto's* shareholding in question been an investment in the Energy Sector or had the 1998 Russian-Ukraine BIT of 17 November 1998 been in force (as of December 2006 it has yet to be implemented), *Sovtransavto* would surely have travelled the BIT route. It can be speculated that it went to the European Court of Human Rights – where it won - precisely because neither of these two avenues was available to it.

Sovtransavto did exactly what the European Court of Human Rights suggested in *Lithgow*: it employed the convention mechanism for investment protection. In the words of *Lithgow*:

"[The reference to general principles of international law] enables non-nationals to resort directly to the machinery of the Convention to enforce their rights on the basis of the relevant principles of international law, whereas otherwise they would have to seek recourse to diplomatic channels or to other available means of dispute settlement to do so."[4]

Article1 (1) 2nd sentence of Protocol No 1 is not an umbrella clause that "mirrors" customary law rules on expropriation of property belonging to non-nationals. It

3 *Sovtransavto Holding v. Ukraine*, No. 48553/99, ECHR 2002-VII.
4 *Infra.*, paragraph 115.

imports standards of customary international law into the Convention. The effects, however, are equivalent.

C. The Convention Perspective on the State's Right to Regulate

It is also worth observing that the *Lithgow* judgment contains a very interesting explanation of the difference between the protection of property rights afforded to nationals and non-nationals under the ECHR:

"Especially as regards a taking of property effected in the context of a social reform or an economic restructuring, there may well be good grounds for drawing a distinction between nationals and non-nationals as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals".[5]

This explanation is based on two reasons for differential treatment:

- The first is what one might call the 'Boston Tea Party' rule: "No regulation without representation."
- The second reason is the fact that the national of the State in question is a member of the public in whose interest the measure has been taken; a consideration which is not relevant in the case of a non-national. The non-national has invested in the country but is not necessarily integrated to such an extent that he would enjoy the benefits of the regulation.

Both reasons are relevant in the context of the present discussion on a host state's right to regulate in a BIT context. They militate for investor protection and against

5 Supra., paragraph 116. The *Lithgow* arguments are echoed by *Paulsson* in support of a general distinction between human rights and investment protection. He does not address Article 1 of Protocol 1, which provides for a distinction between national and non-nationals; *Paulsson*, "Indirect expropriation is the right to regulate at risk," at the joint UNCTAD, OECD and ICSID Conference "Making the Most of International Investment Agreements", 12 December 2005, http://www.oecd.org/document/1/0,2340,en_2649_33783766_35501697_1_1_1_1 ,00.html.

an unlimited right of the host state to regulate unless such a regulation is combined with an obligation to compensate if investor and investment specific considerations so required. This 20 year-old reasoning in *Lithgow* is fresh as well as topical and it deserves to be explored further.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Comment by *Rudolf Dolzer*[*]

Our speaker has presented an impressive panorama of the diversity of international rules governing private property. These rules emanate from customary international law governing aliens, from the body of rules protecting human rights, from treaties regulating international trade and from conventions on the promotion and protection of foreign investment. Even a cursory consideration of the various rules on property as contained in these diverse areas of international law points to differences and to divergences in their content and the level of protection granted to the owners of the property.

In view of these obvious differences, the question will be raised whether the differentiations must be seen as undesirable fragmentations of diverse lawyers of international law in need of a comprehensive synthesis or as expressions of appropriate distinctions inherent in the diversity of objectives of international law. The debate on the possible integration of a future global investment regime into the scheme of the World Trade Organisation has carried overtones of the view that more integration is necessary and that the diversity of the existing rules will need to be reconsidered. Also, the occasional drawing of analogies, in the legal analysis of individual issues, from one of the four areas to another one, has implicitly assumed that uniformity among these areas is appropriate and desirable.

In my own view, the diversity of the rules echoes the diversity of objectives, and there is no reason to alter the existing scheme of rules. All of the four areas have their own legal characteristics. Customary law regarding the status of property held by an alien is an expression of the minimum standard of decency and civilisation which states have come to expect from each other and which each state has to accept as a member of the community of nations. The rules on property contained in human rights investment are meant to reflect and secure the well-being and the dignity of each person which a state has to respect in its treatment of all persons, including its own nationals. Trade law essentially focuses on creating a level playing field for all actors involved in the international exchange of goods, allowing for sound competition and the optimal allocation of resources. And, again different, treaties on foreign investment aim a reducing the political risks of the foreign investor who acquires an

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investment, often for high initial costs and expects a fair rate of return, often over a long period.

Thus, the differences in the content of the rules are dictated by the different objectives, and they cannot be seen as accidental characteristics of uncoordinated fragmentation. Specific conclusions result from this diversity inherent in the difference of goals.

On the doctrinal level, every effort to draw analogies between the different fields in principle runs the danger to ignore the differences in the legal context and purpose of each set of rules. Under certain circumstances, cross-references may still be possible; for instance, it is reasonable to assume that the standard afforded in an investment treaty will not be lower than the protection afforded in a human rights agreement. An example of the limits of drawing on the notions and results in other fields concern the understanding of the requirement of national treatment which at first sight would seem to be identical in all areas concerned. However, recent jurisprudence convincingly demonstrates that the legal context of trade rules and investment rules does not permit analogies in every case and indeed may require different approaches (see *R. Dolzer*, National Treatment, OECD 2005).

Given the diversity of purpose and objective, an effort to synthesize and harmonize or unify the rules concerned seems neither possible nor desirable. With regard to the difference between the status of human rights and the law of aliens, in particular, it is reasonable to assume that the difference will remain existent for the foreseeable future.

Consistent with my emphasis on the fact that the differences are inherent in nature, I am also sceptical on any effort to bring trade and investment rules under one organizational roof. Of course, it may be argued that both areas should retain their characteristics and nevertheless be managed by the same organization, in concreto the World Trade Organization. In my view, the advantages of such a re-organization are not apparent. In the first place, it seems to be obvious that the WTO continues to struggle with its own complexity and that an addition of a new major task such as the administration of investment rules would add to this complexity and thus lead to more stagnation, Moreover, the addition of investment rules would move the WTO into the direction of a world economic organization, in danger of imposing uniform policies where diversity may be more appropriate and where mistakes would be multiplied in their effects. Form this perspective, the decision not to pursue global investment rules specifically within the WTO may not have to be deplored.

Our speaker has also addressed the different question whether the present patchwork of bilateral and multilateral treaties on investment might not better be replaced by a single global convention. In my view, it is in any event useful to separate this question from the issue of an institutional link with the WTO and to consider it on its own merits. At first sight at least, it is far from obvious why a global framework would be appropriate for trade matters but not for the rules on investment. This is so especially today when developing states no longer see investment treaties as an undue impediment to their economic sovereignty but as an entrance card to the growing international markets of foreign investment and thus to gain access to fo-

reign capital and know how. In recent years, developing states have concluded more investment treaties among themselves than with industrialised states. In my view, a global convention, if accepted widely, would also contribute to introduce and strengthen those disciplines necessary for good governance in the host states and thus to contribute to growth and the reduction of poverty in countries and regions which have fallen behind in the competition for foreign investment in the past decade, in particular in Africa. Finally, a global agreement could replace the current multitude of rules with much more simplicity and transparency.

It is not overlooked her that the negotiation of a global investment convention, outside the WTO would face major hurdles. Firstly, the time and effort needed for such negotiations would be enormous. Secondly, the industrialized countries would not be inclined to accept a convention providing less protection than their bilateral treaty programmes, while developing countries might be inclined to further insist on regulatory space for changing policy concepts. The issue of the further status of the existing treaties would also have to be resolved on another level, even among industrialized countries, significant differences in their policies remain, particularly in regard to the function of treaties as a vehicle for the opening of domestic markets. Given these open issues, it remains a matter of political will whether or not a new round of negotiation should be opened for a global investment treaty, this time outside the WTO. It is true that after the failures within the OECD in the 90's and within the WTO more recently, a certain fatigue to renew these efforts has taken over, not surprisingly. At the same time, the advantages of a global investment treaty remain on the table, and the topic remains on the international economic agenda.

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The International Convention on the Settlement of Investment Disputes (ICSID)

Taking Stock after 40 Years

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FOREWORD

On 18 October 1966, the International Convention on the Settlement of Investment Disputes (ICSID) entered into force. After a rather slow start, the system of mixed dispute settlement established by the ICSID Convention has begun to develop at a remarkable pace and is today rightly seen as a corner-stone of international dispute settlement in the field of international economic law. In addition to its immense practical relevance, international investment arbitration has developed in such a way that it is – equally rightly – held to be one of the intellectually most fascinating and challenging areas of modern international law. Consequently, the Wilhelm Merton Center for European Integration and International Economic Order has always considered international investment law to be one of its major fields of scholarly interest.

Therefore, its directors strongly welcomed the initiative taken by Dr. *Christian J. Tams*, Senior Research Assistant with the Walther Schücking Institute for International Law at the University of Kiel, to organise a symposium on current issues of ICSID law. This symposium took place on 26 – 28 April 2006 in Frankfurt am Main, and brought together a large number of investment experts from all over Europe. Opened with a keynote speech by Professor Dr. *Christoph Schreuer*, University of Vienna, who gave a general assessment of modern developments in investment law, the symposium was designed to allow six younger scholars and practitioners to present papers on salient issues of ICSID law. The ensuing discussions were initiated by comments from more experienced participants, again from both academia and practice. The present volume brings together the keynote speech as well as these various papers and comments, and, it is hoped, will give readers a good insight into the major problems currently faced by international investment arbitration under the ICSID Convention.

The directors of the Wilhelm Merton Center wish to use this opportunity to express their sincere gratitude to the Frankfurt am Main based sponsors of this symposium, namely Baker & McKenzie, Clifford Chance LLP, Freshfields Bruckhaus Deringer, Lovells, and Shearman & Sterling LLP, for their financial support. They also wish to thank Dr. *Christian J. Tams* for his strong and continuous intellectual input throughout the project. Finally, the editors of this volume wish to thank Ms *Christina Pfaff*, LL.M., for her most valuable assistance before, during and after the symposium, and Mr *Gennadi Rudak* for his editorial skills.

Frankfurt am Main, 25 January 2007

Rainer Hofmann Stefan Kadelbach Rainer Klump

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Introduction: The International Convention on the Settlement of Investment Disputes (ICSID) – Taking Stock after 40 Years

Rainer Hofmann/Christian J. Tams[*]

Forty years ago, on 18 October 1966, the International Convention on the Settlement of Investment Disputes (ICSID) entered into force. It was quickly ratified by a rather large number of States and was received very favourably by most commentators, one of whom, *Georg Schwarzenberger* (not otherwise known for over-enthusiasm or idealism), considered it a "remarkable" and "astounding" "essay in multilateral law-making".[1] Notwithstanding this positive assessment, and the great expectations coming with it, ICSID dispute settlement took a very slow start and for a long while looked destined to fail. Few cases were brought in the 1970s and 1980s, and those that were often dragged on for years before an eventual award was rendered (which then faced the risk of annulment by *ad hoc* committees).

As is well-known, the pendulum has swung back again, and most commentators today would happily subscribe to *Schwarzenberger's* initial assessment. From the 1990s, the system of mixed dispute settlement established by the ICSID Convention has begun to develop at a remarkable pace. The simplest, and yet most impressive, figure attesting to that development is the number of cases submitted to dispute settlement by ICSID arbitral tribunals. Whereas there tended to be an average of one case per year in the period between 1966-1996, the last decade has witnessed a sharp increase in the number of ICSID proceedings, with currently 108 cases pending before arbitral tribunals.[2] There is no shortage of metaphors describing this dynamic, or frantic, development. Some have spoken of a “baby-boom” of investment arbitration,[3] while others have likened ICSID to Sleeping Beauty, kissed awake by Prince Charming some time during the 1990s.[4] But apart from inspiring writers to use

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1 *Schwarzenberger*, Foreign Investments and International Law (1969), at p. 152.

2 See the list of cases provided on the ICSID website: http://www.worldbank.org/icsid/cases/pending.htm (visited 19 January 2007).

3 *Alexandrov*, 'The "Baby Boom" of Treaty-based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*', The Law and Practice of International Courts and Tribunals 4 (2005) , pp. 19.

4 *Obadia*, “ICSID, Investment treaties and Arbitration: Current and Emerging Issues”, in ICSID News, Vol. 18/2 (2001), available at http://www.worldbank.org/icsid/news/n-18-2-4.htm.

flowery language, investment law, with increasing numbers of ICSID proceedings and increasing amounts of damages sought, has gained an immense practical relevance, while also raising ever more complex conceptual issues.

While the pace of this development is astonishing, ICSID's increase in relevance has been facilitated by a number of factors. Two of them are regularly mentioned and remain valid. (i) The conclusion, by States, of ever more (bilateral and multilateral) investment treaties providing for dispute settlement by ICSID arbitral tribunals, has been decisive, as has been (ii) the solid increase in foreign investment. But these 'structural' reasons alone cannot explain the flood of new cases submitted to ICSID arbitration. As anyone looking at the list of pending ICSID cases will quickly realise, one particular State's economic policy has been equally influential: Argentina's response to the economic crisis of 2000-2002 is responsible for more than 1/3 of the proceedings currently pending, and without it, the increase in the number of ICSID proceedings (while still impressive) would be less astounding. In addition, though this is not always fully appreciated, ICSID arbitral tribunals themselves have played an important part. When called upon to interpret and apply key concepts of investment protection, they have generally adopted rather expansive approaches. Recent ICSID jurisprudence has notably widened the notion of 'investment' and has adopted an broad analysis of core substantive standards of investment protection (e.g. expropriation or fair and equitable treatment). In addition, arbitral tribunals have relied on umbrella clauses found in many bilateral investment treaties to widen the circle of potential claimants, and have also embraced claims by minority shareholders. This in turn has greatly expanded the scope of ICSID arbitration, both *ratione personae* and *ratione materiae* – not always to the liking of States, and at times provoking harsh responses by governments suffering defeats before ICSID arbitral tribunals.

At the same time, the developments sketched out in the preceding paragraphs have changed the character of investment arbitration: ICSID arbitration is no longer seen as the prerogative of a handful of specialists, but faces new challenges. Among them is what might be called the *challenge of legitimacy*, fuelling demands for a more transparent process of dispute settlement and a move away from traditional and confidential proceedings behind closed doors, especially in proceedings involving questions of environmental protection or labour standards. To exemplify the perception of investment arbitration as illegitimate, it may be helpful simply to cite *Anthony DePalma*'s oft-quoted remark about the working of investment tribunals: "Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a group of international tribunals handles disputes between investors and foreign governments can lead to national laws being revoked and environmental regulations changed. And it is all in the name of protecting foreign investors under NAFTA."[5]

5 *DePalma*, 'NAFTA's Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say', in: New York Times, 11 March 2001, Section 3, p. 1.

But legitimacy is not the only challenge facing investment arbitration. Another challenge is that of *(in)consistency*: a mechanism relying on *ad hoc* tribunals runs a considerable risk of producing inconsistent awards. Even in the 1970s or 1980s, when few cases were submitted, that risk of course could never be completely avoided; however, with proceedings mushrooming, it seems more acute than ever and can no longer be neglected. In fact, ICSID tribunals have openly criticised previous awards, and some of the decisions involving similar or identical questions of law and fact seem to hard to square. This in turn endangers the reliability and predictability of ICSID dispute settlement, *i.e.* reasons for which the mechanism has been established in the first place.

Finally, ICSID faces a *challenge of coordination*: paraphrasing a famous dictum about WTO law, one might say that investment law "cannot be read in clinical isolation",[6] or that in any event, that its days of splendid isolationism are over. ICSID tribunals regularly apply the rules of State responsibility, cite decisions of other international courts and tribunals, and interpret treaties according to the general rules of treaty interpretation. Conversely, ICSID jurisprudence contributes (and is increasingly recognised as a contributing element) to the development of international law generally. What is more, ICSID dispute settlement does not exist in isolation either. Given the continued debate about the role of investment within the WTO framework, ICSID might turn out to be an attractive forum for the litigation of some violations of WTO law. At the same time, bearing in mind the close connection between investment protection and property rights, investors that fail to establish standing before ICSID tribunals might eventually be tempted to seek relief before human rights institutions.

The papers put together in the present volume do not purport to analyse these developments exhaustively. Yet they address some of the more important controversies facing the ICSID Convention's dispute settlement mechanism as it enters its fifth decade. They have grown out of a conference convened by the *Wilhelm Merton Center* at the University of Frankfurt, on 25-27 April 2006, which brought together academics and practitioners with an interest in investment arbitration.

As the conference, the book opens with "The Dynamic Evolution of the ICSID System" by *Christoph Schreuer*. This paper, which was the keynote speech of the conference, provides a general assessment of modern developments in investment law (fittingly, given the number of Argentine cases, following the moves of a tango). Situating the ICSID Convention in the broader historical context, *Schreuer* stresses the many advantages of investment arbitration, which provides for conditions conducive to foreign investment, while also helping to defuse political tensions between developing and industrialised countries. However he also underlines that, faced with concerns by host States, ICSID must remind some of its clients of these benefits, and must avoid to be perceived as a one-sided mechanism favouring investors.

6 Cf. the WTO Appellate Body, United States - Standards for Reformulated and Conventional Gasoline (WT/DS2/AB/R), p. 17.

Schreuer's introduction is followed by three papers exploring reasons of ICSID's recent popularity. *Stephan Schill's* paper (with comments by *Kaj Hober* and *Jo Delaney*) provides a detailed analysis of the fair and equitable treatment standard. Although found in a great number of bi- and multilateral investment treaties, that standard has been unduly neglected in the literature. *Schill* identifies its core elements and shows that it emerges as one of the key concepts in international investment law.

Next in line is *Richard Happ* (with comments by *Michael Kerling* and *Anthony Sinclair*) who addresses two concepts that traditionally were considered to restrict the competence of ICSID tribunals, namely the 'foreign nationality' requirement and the 'exhaustion of local remedies' clause. Assessing recent ICSID jurisprudence, *Happ* notably shows that arbitral tribunals have yet to find a consistent and convincing approach to claims by companies controlled by nationals of the host State (as in the case of *Tokios Tokeles*[7]), or to claims by companies that are mere shells.

Alexander Szodruch then deals with a more specific problem, but one of immense practical and conceptual interest: that is the problem raised by the insolvency of a host State. In his paper (commented on by *Peter Gnam* and *August Reinisch)*, he analyses the legal standards applicable to Argentina's *pesification* measures and, *inter alia,* clarifies how arbitral tribunals have rejected Argentina's defence based on the concept of 'necessity'. Beyond that, he shows how the present debate forces us to abandon cherished distinctions between the law of international investment and the international finance, and inquires how State insolvency could change (and could be changed by) investment law.

The final three chapters then take up the different challenges to ICSID dispute settlement alluded to above. *Carl Zöllner's* paper (with comments by *Karl-Heinz Böckstiegel* and *Noah Rubins*), analyses what has been called the *challenge of legitimacy,* and in so doing offers a first analysis of the recent ICSID institutional reform debate. *Zöllner* argues that transparency and broader public participation are vital in ensuring the acceptance and democratic legitimacy of investment arbitration and could also foster coherence in international investment law. This approach also leads him to welcome recent ICSID decisions admitting *amicus curiae* briefs[8] and the results of the recent reform of the ICSID Arbitration Rules.

Christian J. Tams (with comments by *Richard H. Kreindler* and *Asif H. Qureshi*) then inquires whether "There [Is] a Need for an ICSID Appellate Structure?", thus assessing whether faced with a *challenge of (in)consistency*, investment arbitration

7 *Tokios Tokeles v. Ukraine* (Case No. ARB/02/18), Decision on Jurisdiction of 29 April 2004 (*Weil* (presiding), *Bernardini*, *Price*).

8 *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A., and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae* (19 May 2005); *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as *Amicus Curiae* (17 March 2006).

should move towards a two-level system of dispute settlement. He suggests that at present, there are no compelling reasons to move towards an investment appellate structure. Instead, the risk of inconsistency could be reduced by consolidating cases or ICJ proceedings, or (if a reform should prove unavoidable) through the introduction of a reference procedure along the lines of Art. 234 TEC.

Finally, *Christina Pfaff's* paper (with comments by *Rudolf Dolzer* and *Sabine Konrad*) leaves the framework of ICSID arbitration proper. Taking up the *challenge of coordination*, it discusses the role (if any) that human rights institutions and also the WTO may play in the process of investment protection. While noting that there is a potential for overlap, *Pfaff* stresses the advantages of ICSID arbitration and argues that human rights institutions or the WTO are unable to safeguard foreign investment effectively.

Taken together, the seven papers and twelve comments provide a broad spectre of views on the current state of dispute settlement under the ICSID Convention. Readers expecting one single grand theory explaining the successes and failures of forty years of ICSID dispute settlement will look in vain. Yet the contributions to the present volume underline reasons for ICSID remarkable success and highlight future challenges. It is the editors' hope that in addition, at least implicitly, they will convince readers that investment arbitration is rightly regarded as one of the most fascinating areas of modern international law.

The Dynamic Evolution of the ICSID System

Christoph Schreuer[*]

A. Investment and Development

There is broad consensus, that private investment is the most important factor in economic development. This has led most developing countries to revise their previously reserved attitudes towards FDI and to adopt an open and welcoming attitude towards foreign investors.[1]

Much of the investment climate in a country will consist of economic and political factors such as market access, the availability and cost of production factors, taxation, the existence of infrastructures, the existence of a functioning public administration, the level of corruption and political stability.

In addition to economic and political factors, the legal framework for FDI is also important in determining its investment climate. A particularly important aspect of the legal protection of foreign investments is the settlement of disputes between host States and foreign investors. Impartial and effective dispute settlement is an essential element in the protection of investments.

B. Protecting Foreign Investments - Procedural Alternatives

In the absence of other arrangements, a dispute between a host State and a foreign investor will normally be settled by the domestic courts of the host State. From the investor's perspective, this type of dispute settlement carries important disadvantages. Rightly or wrongly, the courts of the host State are often not seen as sufficiently impartial in this type of situation. In addition, domestic courts are bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes.

Domestic courts of other States are usually not a realistic alternative. In most cases, they will lack territorial jurisdiction over investment operations taking place in another country. In addition, sovereign immunity and other judicial doctrines will usually make such proceedings impossible.

* *Christoph Schreuer* is Professor of International Law at the University of Vienna, Austria.

1 See World Investment Report 2003, FDI Policies for Development: National and International Perspectives, UNCTAD (2003).

Diplomatic protection was a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in the relations of the States concerned.

Today, direct arbitration between the host State and the foreign investor is the preferred option for the settlement of investment disputes. International arbitration provides an attractive alternative to the settlement of investment disputes by national courts or through diplomatic protection. Arbitration is usually less costly and more efficient than litigation through regular courts. It offers the parties the opportunity to select arbitrators who enjoy their confidence and who have the necessary expertise in the field. Moreover, the private nature of arbitration, assuring the confidentiality of proceedings, is often valued by parties to major economic development projects.

If arbitration is not supported by a particular arbitration institution, it is referred to as *ad hoc* arbitration. *Ad hoc* arbitration requires an arbitration agreement that regulates a number of issues. These include the selection of arbitrators, the applicable law and a large number of procedural questions. A number of institutions, like UNCITRAL, have developed standard rules that may be incorporated into the parties' agreement. But *Ad hoc* arbitration is subject to the rules of the arbitration law of the country in which the tribunal has its seat. The enforcement of awards rendered by such tribunals is subject to the same rules as awards by tribunals dealing with commercial cases.

C. Tango: Two Steps Forward - One Step Back

I. Step One: The ICSID Convention

In this situation, the ICSID Convention[2] was a major step forward. It is designed to close an important procedural gap. It was drafted in the 1960ies and entered into force in 1966. It currently has 143 Parties.

2 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 575 UNTS 159 (1966); 4 ILM 532 (1965).

1. Purpose and Advantages

The idea of the ICSID Convention is to stimulate investment and hence economic development[3] by improving the standard of protection for foreign investments and the overall investment climate.

Compared to *ad hoc* arbitration, the ICSID Convention offers considerable advantages: it offers a system for dispute settlement that contains not only standard clauses for submission and rules of procedure but also institutional support for the conduct of proceedings. It assures the non-frustration of proceedings and provides for an award's recognition and enforcement.

2. Jurisdiction

The ICSID Convention is specialized in the settlement of investment disputes. Therefore, the existence of a legal dispute arising directly out of an investment is a prerequisite for ICSID's jurisdiction.[4] The concept of an investment is not defined in the Convention but many BITs and multilateral treaties contain definitions of investment.

In actual practice, the concept of "investment" has been given a wide meaning. A variety of activities in a large number of economic fields have been accepted as investments. In addition to traditional typical investment activities, these include pure financial instruments like the purchase of government bonds and the extension of loans.[5] They also include civil engineering contracts like the construction of a highway[6] and certain other services.[7] Decisive criteria are a certain duration of the relevant activities, an element of profit, the presence of a certain economic risk, a substantial commitment as well as the relevance of the project for the host State's development.

Proceedings under the Convention are always mixed. One party (the host State) must be a State party to the Convention. The other party (the investor) must be a national of another Contracting State. Either party may initiate the proceedings but in actual practice it is nearly always the investor who is the claimant.

3 ICSID Convention, Preamble, para. 1.

4 ICSID Convention, Article 25(1).

5 *Fedax* v. *Venezuela*, Decision on Jurisdiction, 11 July 1997, 5 ICSID Reports 186; *Československá Obchodní Banka A.S.* v. *Slovakia*, Decision on Jurisdiction, 24 May 1999, 5 ICSID Reports 335; *CDC* v. *Seychelles*, Award, 17 December 2003.

6 *Salini Costruttori* v. *Morocco*, Decision on Jurisdiction, 23 June 2001, 42 ILM 609 (2003); *Bayindir* v. *Pakistan*, Decision on Jurisdiction, 14 November 2005.

7 *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406; *SGS* v. *Philippines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518.

An additional requirement is that the investor must not be a national of the host State. But if a foreign investor operates through a company that is registered in the host State, it is possible for the investor and the host State to agree that the company will be treated as a foreign investor because of foreign control.[8] The nationality requirements under the ICSID Convention as well as under bilateral treaties have led to some creative nationality planning. For instance, an investor may create a company in a particular State for the primary purpose of gaining access to international arbitration.

Access to investment arbitration, including ICSID arbitration, requires consent to jurisdiction by both parties. Participation in the ICSID Convention does not amount to consent to jurisdiction.[9] This consent may be given in several ways. Consent may be contained in a direct agreement between the investor and the host State such as a concession contract. Alternatively, the basis for consent can be a standing offer by the host State which may be accepted by the investor in appropriate form. Such a standing offer may be contained in the host State's legislation. A standing offer may also be contained in a treaty to which the host State and the investor's State of nationality are parties. Most BITs and some regional treaties dealing with investments contain such offers. The more recent cases that have come before ICSID show a trend away from consent through direct agreement between the parties towards consent through a general offer by the host State which is later accepted by the investor often simply through instituting proceedings.

3. Characteristics

Proceedings under the ICSID Convention are self-contained. This means that they are independent of the intervention of any outside bodies. In particular, domestic courts have no power to stay, to compel or to otherwise influence ICSID proceedings.[10] Domestic courts would have the power to order provisional measures only in the unlikely case that the parties agree thereto.[11] An annulment or other form of review of an ICSID award by a domestic court is impermissible.

The principle of non-frustration means that a case will proceed even if one party fails to cooperate. This circumstance alone will be a strong incentive to cooperate. ICSID proceedings are not threatened by the non-cooperation of a party. If one of the parties should fail to act, the proceedings will not be stalled. The Convention provides a watertight system against the frustration of proceedings by a recalcitrant party. *E.g.*: arbitrators not appointed by the parties will be appointed by the Centre[12];

8 Article 25(2)(b) of the Convention.
9 ICSID Convention, Preamble, para. 7.
10 Article 26 of the Convention.
11 ICSID Arbitration Rules Article 39(6).
12 Article 38 of the Convention.

the decision on whether there is jurisdiction in a particular case is with the tribunal[13]; non-submission of memorials or non-appearance at hearings by a party will not stall the proceedings[14]; non-cooperation by a party will not affect the award's binding force and enforceability.

The system of arbitration is highly effective. This effectiveness is the result of several factors: Submission to ICSID's Jurisdiction is voluntary but once it has been given it may not be withdrawn unilaterally.[15]

Awards are binding and final and not subject to review except under the narrow conditions provided by the Convention itself.[16] Non-compliance with an award by a State would be a breach of the Convention and would lead to a revival of the right to diplomatic protection by the investor's State of nationality.[17]

The Convention provides an effective system of enforcement. Awards are recognized as final in all States parties to the Convention. The pecuniary obligations arising from awards are to be enforced like final judgements of the local courts in all States parties to the Convention.[18] Domestic courts have no power to review ICSID awards in the course of their enforcement. However, in the case of an award against a State the normal rules on immunity from execution will apply.[19] In actual practice this will usually mean that execution is not possible against assets that serve the State's public functions.

The system of dispute settlement under the ICSID Convention is likely to have an effect even without its actual use. The mere availability of an effective remedy will influence the behaviour of parties to potential disputes. It is likely to have a restraining influence on investors as well as on host States. Both sides will try to avoid actions that might involve them in arbitration that they are likely to lose. In addition, the prospect of litigation will strengthen the parties' willingness to settle a dispute amicably.

4. Caseload

ICSID had a slow start. The Convention entered into force in 1966 but the fist case was not registered before 1972. The 1970ies and 1980ies saw steady but only intermittent action. One or two cases per year were typical for that period.

The last ten years have seen a dramatic increase in activity. In 1995 there were four ICSID arbitrations pending. Today (26 April 2006) more than 100 are pend-

13 Article 41 of the Convention.
14 Article 45 of the Convention.
15 Article 25(1) of the Convention.
16 Article 53(1) of the Convention.
17 Article 27(1) of the Convention.
18 Article 54(1) of the Convention.
19 Article 55 of the Convention.

ing.[20] During 2005 27 new cases were registered. Therefore, more than two new cases per month are registered on average.

II. Step Two: The BIT Regime

1. Consent to Jurisdiction

A second big step forward in investment arbitration was the discovery and use of bilateral investment treaties (BITs) as basis for jurisdiction in investment arbitration. BITs have existed for some time. But their number has increased enormously during the 1990ies. In addition, regional treaties such as NAFTA and ECT also offer jurisdiction.

In the earlier cases of investor-State arbitration jurisdiction was always based on contracts between investors and host States. During the last 10 years most cases were brought on the basis of treaty provisions. [21] This has led to an enormous increase in the number of cases. It has also changed the character of the cases.

The vast majority of BITs contain clauses referring to investor-State arbitration. The States parties to the BIT offer consent to arbitration to investors who are nationnals of the other contracting party.

The dispute settlement clauses in many BITs offer several possibilities. These may include the domestic courts of the host State, procedures agreed to by the parties to the dispute, ICSID arbitration, ICC arbitration, and *ad hoc* arbitration often under the UNCITRAL rules.

A provision on consent to arbitration in a BIT is merely an offer by the respective States that requires acceptance by the other party. The arbitration agreement is perfected through the acceptance of that offer by an eligible investor, *i.e*. a national of the other State party to the BIT.

It is established practice that an investor may accept an offer of consent contained in a BIT by instituting ICSID proceedings. Therefore, where a BIT of this kind is in place, an investor no longer needs a formal arbitration agreement with the host State but can simply invoke the BIT. The Tribunal in *Generation Ukraine* v. *Ukraine* said:

"... it is firmly established that an investor can accept a State's offer of ICSID arbitration contained in a bilateral investment treaty by instituting ICSID proceedings. There is nothing in the BIT to suggest that the investor must communicate its consent in a different form directly to the State; ... It follows that the Claimant validly

20 For detailed information on pending cases see: http://www.worldbank.org/icsid/cases/pending.htm.

21 The first case in which consent was based on a BIT was *AAPL* v. *Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 250.

consented to ICSID arbitration by filing its Notice of Arbitration at the ICSID Centre."[22]

Treaty clauses providing for investor/State arbitration vary in scope. Some refer to all disputes concerning investments. Other treaties just refer to violations of the treaty itself. For instance, both the NAFTA[23] and the ECT[24] offer arbitration just for violations of the respective treaty itself.

Some BITs offer consent to jurisdiction in narrow terms. For instance, most BITs of China only offer jurisdiction for disputes about the amount of compensation for expropriation owed to an investor. But in China's most recent BITs (notably with Germany) jurisdiction extends to any dispute with respect to investment.

2. Umbrella Clauses

The scope of consent offered in a BIT may also be affected by an umbrella clause contained in the treaty. An umbrella clause is a provision in a treaty under which the States parties undertake to observe any obligations they may have entered into with respect to investments. In other words, contractual obligations are put under the treaty's protective umbrella. After some initial hesitation, most tribunals have now accepted that under the regime of an umbrella clause, violations of the contract become treaty violations.[25] Therefore, a provision in a BIT offering consent to arbitration for violations of the BIT extends to contract violations covered by the umbrella clause.

3. MFN Clauses

Most BITs and some other treaties for the protection of investment[26] contain most favoured nation or MFN clauses. A MFN clause contained in a treaty will extend the better treatment granted to a third State or its nationals to a beneficiary of the treaty. This has led to the question of whether the effect of MFN clauses is restricted to substantive standards or extends to the provisions on dispute settlement in these treaties. Put differently, is it possible to avoid the limitations attached to consent to arbitration in a treaty by relying on an MFN clause in the treaty if the respondent

22 *Generation Ukraine* v. *Ukraine*, Award, 16 September 2003, paras. 12.2, 12.3.
23 Article 1116 NAFTA.
24 Article 26(1) ECT.
25 *SGS* v. *Philipines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518; *Eureko* v. *Poland*, Partial Award, 19 August 2005; *Noble Ventures* v. *Romania*, Award, 12 October 2005; *MTD* v. *Chile*, Award, 25 May 2004. But see: *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406; *El Paso Energy Intl. Co.* v. *Argentina*, Decision on Jurisdiction, 27 April 2006.
26 See Article 1103 NAFTA.

State has entered into a treaty with a third State that contains a consent clause without the limitation? For instance, would a national of a country that has an old style BIT with China, providing for jurisdiction only for the amount of compensa-tion, be able to invoke an MFN clause to benefit from China's new BIT with Germany with its broad jurisdictional clause? Or even more radically, if the treaty con-taining the MFN clause does not offer consent to arbitration, is it possible to rely on consent to arbitration in a treaty of the respondent State with a third party?

Tribunals have used MFN clauses in a number of cases to overcome procedural obstacles where consent to jurisdiction had been given in the basic treaty.[27] But the issue whether an MFN clause can be used to establish jurisdiction which does not otherwise exist is an open question. I would tend to agree with Emmanuel Gaillard[28]: why not?

4. Shareholder Protection

Another area where big strides have been made is shareholder protection.[29] Investments often take place through the acquisition of shares in a company that has a nationality different from that of the investor.

The classical position was represented by *Barcelona Traction*[30]: only corporate rights would be protected and the corporation had to have the right nationality. Under this doctrine, a company established under the law of the host State would be disqualified, in principle, because it did not have the status of a foreign investor. A company established under the law of another State would be disqualified if that State did not have a BIT or another suitable treaty with the host State or because the company's home State was not a party to the ICSID Convention.

The issue is particularly acute where investments are made through companies incorporated in the host State. Many States require a locally incorporated company as a precondition for the investment. The local company would not as such qualify as a foreign investor and would hence be excluded from resorting to international arbitra-

27 *Maffezini* v. *Spain,* Decision on Jurisdiction, 25 January 2000, 5 ICSID Reports 396; *Siemens* v. *Argentina*, Decision on Jurisdiction, 3 August 2004, 44 ILM 138 (2005); *Gas Natural* v. *Argentina*, Decision on Jurisdiction, 17 June 2005. But see: *Salini* v. *Jordan*, Decision on Jurisdiction, 29 November 2004; *Plama* v. *Bulgaria*, Decision on Jurisdiction, 8 February 2005.

28 *Gaillard*, Establishing Jurisdiction Through a Most-Favored Nation Clause, New York Law Journal, June 2, 2005 p. 3.

29 See especially *Alexandrov*, The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction *Ratione Temporis*, 4 The Law and Practice of International Courts and Tribunals 19 (2005); *Schreuer*, Shareholder Protection in International Investment Law, Transnational Dispute Management, Vol. 2, Issue N°. 03, June 2005.

30 *Barcelona Traction, Light and Power Co.*, Ltd. (Belgium v. Spain), Judgement, 5 February 1970, ICJ Reports 1970, p. 4.

tion. This would have deprived a large proportion of foreign investment of international protection.

Contemporary treaty law offers a solution that gives independent standing to shareholders: most BITs include participation in a company in their definition of investment. In this way, the participation in the locally incorporated company becomes the investment. Even though the local company is unable to pursue the claim internationally, the foreign shareholder in the local company may pursue the claim in his own name. Put differently, the local company is not endowed with investor status but the participation therein, is seen as the investment. The shareholder may then pursue claims for adverse action by the host State against the local company that affects its value and profitability. Arbitral practice on this point is extensive and uniform.[31]

This is not a roundabout way of introducing a control theory to the nationality of corporations. Minority shareholders too have been accepted as claimants and have been granted protection under the respective treaties.[32] This practice has also been extended to indirect shareholding through an intermediate company.[33] The same technique has been employed where the affected company was incorporated not in the host State but in a third State.[34]

This shareholder protection extends not only to ownership in the shares but also to the assets of the company. Adverse action by the host State in violation of treaty

31 See *e.g.*: *Antoine Goetz et consorts* c. *République du Burundi,* Decision of 2 September 1998, 6 ICSID Reports 3; *Emilio Augustín Maffezini* v. *The Kingdom of Spain*, Decision on Jurisdiction, 25 January 2000, 5 ICSID Reports 396; *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 6 ICSID Reports 340; *Azurix Corp.* v. *Argentine Republic*, Decision on Jurisdiction, 8 December 2003, 43 ILM 259 (2004); *LG&E Energy Corp*. v. *Argentine Republic*, Decision on Jurisdiction, 30 April 2004; *Plama Consortium Ltd.* v. *Republic of Bulgaria*, Decision on Jurisdiction, 8 February 2005; *AMT* v. *Zaire*, Award, 21 February 1997, 36 ILM 1531 (1997), 5 ICSID Reports 11; *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil* v. *The Republic of Estonia***,** Award, 25 June 2001, 6 ICSID Reports 241; *CME Czech Republic B. V. (The Netherlands)* v. *The Czech Republic*, Partial Award, 13 September 2001; *Camuzzi* v. *Argentina*, Decision on Jurisdiction, 11 May 2005.

32 See *e.g.*: *AAPL* v. *Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 246; *LANCO* v. *Argentina*, Decision on Jurisdiction, 8 December 1998, 5 ICSID Reports 367; *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic* (the *Vivendi* case), Decision on Annulment, 3 July 2002, 6 ICSID Reports 340; *CMS Gas Transmission Company* v. *Republic of Argentina*, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003); *Champion Trading Co. and Ameritrade International Inc.* v. *Arab Republic of Egypt*, Decision on Jurisdiction, 21 October 2003; *GAMI Investments, Inc.* v. *Mexico*, Award, 15 November 2004; *LG&E Energy Corp.* v. *Argentine Republic*, Decision on Jurisdiction, 30 April 2004.

33 See *e.g.*: *Siemens A.G.* v. *Argentine Republic*, Decision on Jurisdiction, 3 August 2004, 44 ILM 138 (2005); *Enron Corp. and Ponderosa Assets, L.P.* v. *Argentine Republic*, Decision on Jurisdiction, 14 January 2004.

34 *Ronald S. Lauder* v. *The Czech Republic*, Award, 3 September 2001, 9 ICSID Reports 66; *Waste Management INC.* v. *United Mexican States*, Award, 30 April 2004, 43 ILM 967 (2004).

guarantees affecting the company's economic position gives rise to rights by the shareholders.[35]

This generous extension of procedural rights to shareholders is likely to lead to some interesting situations. Practical problems may arise where claims are pursued in parallel, especially by different shareholders. In addition, the affected company itself may pursue certain remedies while a group of its shareholders may pursue different ones. The situation becomes even more complex where indirect shareholding through intermediaries is combined with minority shareholding. In such a case shareholders and companies at different levels may pursue conflicting or competing litigation strategies that may be difficult to reconcile and coordinate.

III. Step Three: Backing Off?

Developments have not all been in favour of investors. The enthusiasm for investor protection has been dampened by the sometimes painful experience of States in losing cases. The pain is particularly acute if the damages awarded are high or if there are multiple cases against the State in question. For some countries the mere fact of being sued is already a cause of alarm and a reason to think about ways to limit the access of investors to international arbitration.

Signs of retreat from investment arbitration have manifested themselves in a number of ways. Here are a few examples.

1. The Revival of Domestic Remedies

One is the revival of domestic remedies.[36] International investment arbitration dispenses with the traditional requirement to exhaust local remedies, at least in principle. Article 26 of the ICSID Convention specifically does away with this traditional requirement "unless otherwise stated". Arbitral practice confirms that the exhaustion of local remedies is not required in contemporary investment arbitration.[37]

But States have attempted to counteract international arbitration by inserting forum selection clauses in investment contracts. Under these clauses disputes arising in the context of the contract are to be taken to national courts or tribunals. When the investors instituted international arbitration on the basis of a BIT, the host States

35 *GAMI Investments, Inc.* v. *Mexico*, Award, 15 November 2004.

36 Generally see *Schreuer*, Calvo's Grandchildren : The Return of Local Remedies in Investment Arbitration, 4 The Law and Practice of International Courts and Tribunals, 1-17 (2005).

37 *Lanco* v. *Argentina*, Decision on Jurisdiction, 8 December 1998, para. 39, 40 ILM 457, 469/70 (2001); *Generation Ukraine* v. *Ukraine*, Award, 16 September 2003, paras. 13.1–13.6; *Yaung Chi Oo* v. *Myanmar*, Award, 31 March 2003, para. 40, 42 ILM 540, 547/48 (2003); *Loewen* v. *United States*, Award, 26 June 2003, paras. 142 et seq., 42 ILM 811 (2003).

would object contending that the contractual forum selection clause, pointing to domestic litigation, constituted a waiver of international arbitration.

Tribunals have reacted by adopting the distinction between treaty claims and contract claims. They have held consistently that the contractual clauses pointing to domestic courts did not deprive them of their jurisdiction to hear claims for violations of international law, especially BIT claims.[38]

The distinction between contract claims and treaty claims has become a standard feature of recent investment arbitrations. The Respondent's objection, that the case only involves contract claims and the Claimant's insistence that treaty rights are involved, are routine features of many recent cases. As it turned out, the distinction between treaty claims and contract claims is not always easy. A particular course of action by the host State may well constitute a breach of contract and a violation of international law. The two categories are not mutually exclusive. Rather, two different standards have to be applied to determine whether one or the other or both have been violated. The *ad hoc* Committee in *Vivendi*[39]said:

"... whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract ..."[40]

The situation is made even more complex by the fact that some treaties offer jurisdiction for any investment dispute, which probably includes contract claims. Also umbrella clauses will convert contract breaches into treaty breaches.[41]

The problem with the separate treatment of contract claims and treaty claims is less a theoretical than a practical one. It leads to situations where the claimant is

38 See e.g. *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux* v. *Argentine Republic*, Award, 21 November 2000, 16 ICSID Review – FILJ 643 (2001); 5 ICSID Reports 296; 40 ILM 426 (2001); *Compañía de Aguas del Aconquija, S. A. & Vivendi Universal (formerly Compagnie Générale des Eaux)* v. *Argentine Republic*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 41 ILM 1135 (2002); *Salini Costruttori SpA et Italstrade SpA* c/ *Royaume du Maroc*, Decision on Jurisdiction, 23 July 2001, Journal de Droit International 196 (2002), 6 ICSID Reports 400, 42 ILM 609 (2003); *CMS* v. *Argentina*, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003); *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, 42 ILM 1289 (2003); *Azurix* v. *Argentina*, Decision on Jurisdiction, 8 December 2003; *Enron* v. *Argentina*, Decision on Jurisdiction, 14 January 2004; *SGS* v. *Philippines*, Decision on Jurisdiction, 29 January 2004, 8 ICSID Reports 518; *Siemens* v. *Argentina*, Decision on Jurisdiction, 3 August 2004. For a broader discussion see *Schreuer*, Investment Treaty Arbitration and Jurisdiction over Contract Claims - the *Vivendi I* Case Considered, in *Weiler*, ed., International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law 281-323 (2005).

39 *Compañía de Aguas del Aconquija, S. A. & Vivendi Universal (formerly Compagnie Générale des Eaux)* v. *Argentine Republic*, Decision on Annulment, 3 July 2002, 6 ICSID Reports 340, 41 ILM 1135 (2002).

40 At para. 96.

41 See above at Fn 25.

compelled to pursue part of its claim through national and another part through international procedures. This has undesirable results. The need to dissect cases into contract claims and treaty claims to be dealt with by separate fora requires claim splitting and has the potential of leading to parallel proceedings. This is uneconomical and contrary to the goal of reaching final and comprehensive resolutions of disputes.

Even worse, the separation of types of claims arising from the same set of facts can lead to a situation where a host State, threatened by a treaty claim before an international tribunal, will start domestic proceedings before a local court or domestic tribunal which it can control in order to counteract and frustrate the international proceedings. In this way, the host State can exert pressure on the investor to settle or withdraw the treaty claim. Alternatively, the host State can use the domestic proceedings to recoup the money awarded in the international award through an action for breach of contract against the investor. Put differently, allowing the host State to pursue contract claims from the same dispute in its own domestic forum can undermine the procedural protection granted to the foreign investor in the BIT.

In some cases tribunals have reintroduced domestic remedies in a different way. They have at times indicated that a violation of a treaty standard occurs only once some redress has been sought and denied through proceedings in domestic courts. For instance, a tribunal found that a de facto expropriation could not be assumed in the absence of a reasonable effort to obtain correction in the domestic courts.[42]

Similarly, another tribunal found that the availability of local remedies was relevant to whether the host State had violated the treaty standard of fair and equitable treatment.[43] It is not difficult to see that the rationale in these cases can be developed into something that reintroduces the local remedies rule through the back door.

2. Restricting Substantive Standards

In another attempt to stem the tide of investment claims States have attempted to limit the meaning of the substantive standards granted to investors.

One such attempt concerns the standard of fair and equitable treatment (FET) which is contained in most treaties. This standard has created a considerable amount of case law and is nowadays invoked in almost every case. Its somewhat open ended and flexible nature, has led to attempts to restrict its meaning.

Article 1105(1) of the NAFTA providing for FET has been the subject of an official interpretation by the NAFTA Free Trade Commission (FTC), a body composed of representatives of the three States Parties with the power to adopt binding inter-

42 *Generation Ukraine, Inc*. v. *Ukraine*, Award, 16 September 2003, para. 20.30. See also *Lauder* v. *Czech Republic*, Award, 3 September 2001, para. 204, 9 ICSID Reports 66.

43 *Waste Management, Inc*. v. *United Mexican States*, Award, 30 April 2004, para. 116.

pretations.[44] The FTC interpretation of July 2001 states that Article 1105(1) reflects the customary international law minimum standard and does not require treatment beyond what is required by customary international law.[45] NAFTA tribunals have accepted the FTC interpretation.[46]

The recent BITs of the US and Canada incorporate this approach by stating that FET does not require treatment beyond what is required by customary IL.[47]

Tribunals not operating under such restrictive interpretations have not adopted a dogmatic position on whether the fair and equitable treatment standard contained in BITs is an autonomous standard or merely reflects customary international law.[48] Rather, they have interpreted the relevant provisions in BITs autonomously as a matter of treaty interpretation.[49]

Professor *Dolzer* has pointed out that the attempt to contain the meaning of FET by equating it with customary IL may have exactly the opposite effect. The specific meaning that tribunals have given to fair and equitable treatment may be projected into customary international law. The consequence is that investors may in the future invoke the detailed case law on fair and equitable treatment as part of customary international law even in situations that are not subject to a treaty provision containing that standard.

Another area where there have been recent attempts to dampen the enthusiasm of investors to bring claims against host States has been expropriation. There is a lively debate surrounding the State's right to regulate in the public interest. Of course it is not per se unreasonable for States to insist on their right to regulate. On the other hand, investors predictably insist on the protection of their assets even if the State purports to act in the public interest.

44 Article 1131 (2) NAFTA.

45 FTC Note of Interpretation of 31 July 2001.

46 See *e.g.*: *Mondev International Ltd.* v. *United States of America*, Award, 11 October 2002, 6 ICSID Reports 192, paras. 100 *et seq.*; *United Parcel Service of America, Inc.* v. *Canada*, Award, 22 November 2002, 7 ICSID Reports 288, para. 97; *ADF Group, Inc.* v. *United States of America*, Award, 9 January 2003, 6 ICSID Reports 470, paras. 175–178; *Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America*, Award, 26 June 2003, 7 ICSID Reports 442, paras. 124–128; *Waste Management, Inc.* v. *United Mexican States*, Award, 30 April 2004, paras. 90–91. See also *United Mexican States* v. *Metalclad Corp*., Judgment, Supreme Court of British Columbia, 2 May 2001, 5 ICSID Reports 236, paras. 61–65.

47 US Model BIT 2004, Article 5(1)(2).

48 See *CMS Gas Transmission Company* v. *Argentina,* Award, 12 May 2005 at paras. 282-284 where the Tribunal found that the question whether the standard of fair and equitable treatment was identical with customary international law was not relevant in the case before it since "the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under customary law." At para. 284.

49 See e.g. *Técnicas Medioambientales Tecmed S. A.* v. *The United Mexican States*, Award, 29 May 2003, 43 ILM 133 (2004), paras. 155 and 156; *MTD* v. *Republic of Chile*, Award, 25 May 2004, paras. 110–112; *Occidental Exploration and Production Co.* v. *Ecuador*, Award, 1 July 2004, paras 188–190.

Under classical IL and most treaty provisions dealing with expropriation, the existence of a public purpose is a requirement for the legality of an expropriation together with non-discrimination and appropriate compensation. It would seem to follow that a legitimate public purpose cannot be the basis of an argument that no expropriation has occurred. Rather, the existence of a public purpose is a requirement for the expropriation's legality in addition to compensation.

Recent treaties, especially of the United States state that except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations.[50]

Judge *Schwebel* has referred to these Developments as a "Regressive Development of International Law"[51]. Indeed there is a danger that immunizing interferences with investments on account of their public purpose may seriously undermine the protection against indirect expropriations as we know it.

These ideas have already borne fruit in arbitral practice. In *Methanex* v *US*[52] the Tribunal said quite bluntly that a measure that is taken for a public purpose, is non-discriminatory and is accomplished with due process is not an expropriation but a lawful regulation and hence does not require compensation.[53] This position was subsequently repeated and expanded in *Saluka* v. *Czech Republic*.[54]

There are two kinds of problems with that approach. One is a question of logic. The other is a matter of policy. As a matter of logic, if a lawful expropriation requires a public purpose and full compensation it seems difficult to say that a legitimate public purpose means there is no expropriation but just regulation and therefore no compensation needs to be paid.

The policy issue is perhaps more serious. Once it is accepted that regulatory action for a public purpose by definition is not an expropriation, one is on a very slippery slope. It will not be difficult to find a legitimate public purpose for most measures affecting foreign investors. It would then be for the investor to bear the economic consequences of such measures even if they radically affect the investment. Taken to its logical conclusion this could well spell the end of protection of foreign-owned property as we know it.

50 US Model BIT 2004, Annex B, Para. 4 (b).

51 *Schwebel*, The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law, Transnational Dispute Management, Vol. 3, N° 2, April 2006.

52 *Methanex* v. *United States*, Award, 3 August 2005.

53 At Part IV, Chapter D, paras. 7, 14.

54 *Saluka* v. *The Czech Republic*, Partial Award, 17 March 2006 at paras. 254, 255, 262, 276.

3. Tango Argentino: Some Radical Proposals

Among the States that are unhappy about investment arbitration, Argentina is surely the unhappiest. It has several dozen cases pending against it and there are a number of adverse decisions already although most of these concern jurisdictional ques-tions and are hence preliminary. The aggregate amount in dispute under these cases is staggering and goes into the billions.

Argentina, is considering drastic action. There are a number of proposed bills that foresee:

- denouncing all BITs that foresee international investment arbitration,
- establishing that claims against Argentina may only be brought to Argentinean courts,
- declaring that international arbitral awards are unenforceable unless they have been reviewed by local courts.

These proposals are obviously contrary to Argentina's treaty obligations under the ICSID Convention and under the applicable BITs. From a legal perspective such threats may not carry much weight and are easily dismissed. Nevertheless signs of States becoming weary with the system of investment arbitration should not be taken lightly. Other countries might follow suit and take joint action once they realize that they continue to be on the losing side of investment arbitrations. After all, it is the States that ultimately control the system.

So is investor-State arbitration in danger? The answer is probably: not yet but we should not necessarily take it for granted. There may well be further curtailments or even calls to replace the current system by a State v. State system.

D. Finale: It Takes Two to Tango
The Complementary Interests of Investors and Host States

It is appropriate to keep in mind and to remind States that investment arbitration is not a one-sided system that works all in favour of investors. Investment protection is also in the longer term interest of host States. It is no coincidence that the ICSID Convention was conceived in the framework of the World Bank and that the first sentence of its Preamble refers to the need for international cooperation for economic development and the role of private international investment therein.

Investment arbitration carries more than one advantage to host States. The more obvious advantage is a country's improved investment climate through the possibility of international arbitration. The possibility of going to arbitration is an important element of the legal security required for an investment decision. In other words, by offering arbitration the host State creates an important incentive to foreign investment.

The Tribunal in *Amco* v. *Indonesia*[55] pointed out that:

"...to protect investments is to protect the general interest of development and of developing countries."[56]

In addition, by consenting to ICSID arbitration the host State protects itself against other forms of foreign or international litigation. In particular, a major advantage of ICSID arbitration is that the host State effectively shields itself against diplomatic protection by the State of the investor's nationality.

Before investors received the right to pursue claims on their own behalf on the international level, the standard practice was for their home States to act on their behalf. This method carried political disadvantages for both States. It often created friction between the States concerned and cast a shadow over their relations. Not surprisingly, developing countries do not like being leaned upon by powerful industrialised States. In an investment dispute the limited inconvenience of having to defend a case before an international tribunal may be vastly preferable to the alternative of feeling the pressure of the United States, of Germany or of the European Commission.

Like most successful human endeavours investment arbitration serves the interests of all concerned. It is important to make sure that the system keeps its proper balance but also that everyone concerned is aware of this mutual interest.

55 *Amco* v. *Indonesia*, Decision on Jurisdiction, 25 September 1983, 1 ICSID Reports 389.
56 At para. 23. See also Award, 20 November 1984, 1 ICSID Reports 413, at para. 249.

"Fair and Equitable Treatment" as an Embodiment of the Rule of Law

Stephan Schill[*]

A. Introduction

After forty years of ICSID arbitration it is not only time to take stock of past developments in international investment arbitration. Given above all the widespread criticism investor-state dispute settlement is facing in regard of its restrictive effect on host state law- and policy-making, it is also time to develop more conceptual frameworks with respect to the substantive law contained in international investment treaties. Among other factors, the criticism seems to stem to a large extent from the considerable vagueness of many standard guarantees in international investment treaties[1] and the perception that their interpretation by investment tribunals is unpredictable and comprises the risk of inconsistent or even contradictory interpretation.[2]

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1 See *Soloway*, NAFTA's Chapter 11: The Challenge of Private Party Participation, 16 J. Int'l Arb. 1, 3 (1999) (arguing that the "lack of clarity in Chapter 11 prevents the establishment of a secure and stable framework for investments"); *Ferguson*, California's MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretative Note on Article 1110 of NAFTA, 11 Colo. J. Int'l Envt'l L. & Pol'y 499, 503 (2000) (noting that the "vague language" of NAFTA allows for an "abuse" of investor-state dispute resolution); *Beauvais*, Regulatory Expropriations Under NAFTA: Emerging Principles and Lingering Doubts, 10 N.Y.U. Envt'l L. J. 245, 257 *et seq.* (2001-2002); *Poirier*, The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist, 33 Environmental Law 851, 902 *et seq.* (2003); *Been/Beauvais*, The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine, 78 N.Y.U. L. Rev. 30, 125 *et seq.* (2003) (all noting the vagueness of the expropriation standard under international law); *Porterfield*, An International Common Law of Investor Rights?, 27 U. Pa. J. Int'l Econ. L. 79 (2006) (arguing that fair and equitable treatment due to its vagueness cannot constitute a legitimate norm of international law); *Garcia*, All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration, 16 Fla. J. Int'l L. 301, 350 (2004) (referring to "the vague and unbounded notions of fair and equitable treatment and full protection and security").

2 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1558 *et seq.* (2005).

In this context, commentators frequently allude to a "legitimacy crisis" in investment arbitration.[3]

While initially the protection of foreign investors against indirect expropriations has been the focus of much political and academic debate,[4] more recently another key guarantee of international investment treaties is coming to the fore in the ongoing struggle over the appropriate scope of international investment protection: the standard of fair and equitable treatment. Being attested to have "the potential to reach further into the traditional 'domaine réservé' of the host state than any one of the other rules of [investment] treaties",[5] fair and equitable treatment is emerging as one of the core concepts governing the relationship between foreign investors and host states in international investment law. The standard appears prominently in almost all of the approximately 2400 bilateral investment treaties (BITs) as well as regional and multilateral investment treaties, such as Art. 1105(1) of the North American Free Trade Agreement (NAFTA) and Art. 10(1) of the Energy Charter Treaty (ECT), prior to that figured in the Friendship, Commerce and Navigation Treaties the United States concluded with various countries and played a role in all multilateral projects relating to the protection of foreign investment.[6]

Despite its textual presence in various international legal instruments over a period of over 60 years, fair and equitable treatment has for a long time received surprisingly little attention in academic literature and in the practice of international courts and tribunals. Over the past five years, however, fair and equitable treatment has emerged as a central element on the grounds of which host states are increasingly often ordered to pay damages to foreign investors in disputes before international

3 *Brower*, A Crisis of Legitimacy, Nat'l L. J., Oct. 7, 2002; *Afilalo*, Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis, 17 Geo. Int'l Envt'l L. Rev. 51 (2004); *Franck* (supra note 2), 73 Fordham L. Rev. 1521 (2005).

4 *Dolzer*, Indirect Expropriation: New Developments?, 11 N.Y.U. Envt'l L. J. 64 (2002-2003); *Been/Beauvais* (supra note 1), 78 N.Y.U. L. Rev. 30 (2003); *Brunetti*, Indirect Expropriation in International Law, 5 Int'l L. FORUM du droit int. 150 (2003); *Dolzer/Bloch*, Indirect Expropriation: Conceptual Realignments?, 5 Int'l L. FORUM du droit int. 155 (2003); *Fortier/Drymer*, Indirect Expropriation in the Law of International Investment: I know It When I See It, or Caveat Investor, 19 ICSID Rev. — Foreign Inv. L. J. 293 (2004); *Yannaca-Small*, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law, OECD Working Papers on International Investment, Number 2004/4, available at http://www.oecd.org/dataoecd/22/54/33776546.pdf (all websites visited last on July 11, 2006); *Kunoy*, Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration, 6 J. World Inv. & Trade 467 (2005); *Newcombe*, The Boundaries of Regulatory Expropriation, 20 ICSID Rev. – Foreign Inv. L. J. 1 (2005).

5 *Dolzer*, The Impact of International Investment Treaties on Domestic Administrative Law, 37 N.Y.U. J. Int'l L. & Pol. 953, 964 (2005).

6 See on the history of the fair and equitable treatment standard *Vasciannie*, The Fair and Equitable Treatment Standard in International Investment Law and Practice, 70 Brit. Yb. Int'l Law 99 (1999); *Yannaca-Small*, Fair and Equitable Treatment Standard in International Investment Law, OECD Working Papers on International Investment, Number 2004/3, p. 3 *et seq.*, available at http://www.oecd.org/dataoecd/22/53/33776498.pdf.

arbitral tribunals. Yet, the frequency with which it is invoked by foreign investors and applied as a basis for state responsibility by arbitral tribunals contrasts with an astonishingly fundamental lack of conceptual understanding about the principle's normative content. Given that fair and equitable treatment undoubtedly constitutes a legal standard, not an empowerment of arbitral tribunals to render decisions *ex aequo et bono*,[7] the tribunals are faced with the task to enrich this admittedly vague standard with concrete normative content in order to apply it to the factual circumstances submitted to them.

Although the language of the various investment treaties is not uniform, varying above all between a plain prescription of fair and equitable treatment and a combination of the standard with an explicit reference to international law or the customary international minimum standard,[8] it is questionable whether substantial differences result from the different framing of the standard with a view to the actual practice of investment tribunals. This has become apparent in particular in the NAFTA context where Art. 1105(1) has to be interpreted – pursuant to a binding interpretation by NAFTA's Free Trade Commission under Art. 1131(2) – in accordance with customary international law.[9] Two factors, in particular, level possible differences between treaty law and custom in this context. First, some tribunals held that the inclusion of fair and equitable treatment in the vast web of international investment agreements has transformed the standard itself into customary international law.[10] Secondly, even absent such an explicit transformation, other tribunals interpret the international minimum standard as an evolutionary concept that has evolved since the days of traditional international law concerning the treatment of aliens.[11] This evolution-

7 See *Yannaca-Small* (supra note 6), p. 40; *Schreuer*, Fair and Equitable Treatment in Arbitral Practice, 6 J. World Inv. & Trade 357, 365 (2005); see also *Case Concerning Oil Platforms (Islamic Republic of Iran v. United States of America) – Preliminary Objection*, Judgment of Dec. 12, 1996, ICJ Reports 1996, 803 *et seq.*, Separate Opinion by Judge *Higgins*, par. 39.

8 See *Dolzer*, Fair and Equitable Treatment: A Key Standard in Investment Treaties, 39 Int'l Law. 87, 90 (2005) (explaining that the plain approach prevails in the treaty practice of Germany, the Netherlands, Sweden and Switzerland, whereas the BITs of France, the United Kingdom and the United States generally make reference to international law). See also *UNCTAD*, *Fair and Equitable Treatment*, p. 10 *et seq.* (1999), available at http://www.unctad.org/en/docs/psiteiitd11v3.en.pdf.

9 *NAFTA Free Trade Commission*, *Notes of Interpretation of Certain Chapter 11 Provisions*, 31 July 2001, available at http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

10 See for example *Pope & Talbot v. Canada*, UNCITRAL/NAFTA, Award in Respect of Damages of May 31, 2002, par. 62; similarly *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award of Oct. 11, 2002, par. 125 (all investment awards are, unless explicitly stated otherwise, available via http://www.investmenclaims.com); see also *Hindelang*, Bilateral Investment Treaties, Custom and a Healthy Investment Climate – The Question of Whether BITs Influence Customary International Law Revisited, 5 J. World Inv. & Trade 789 (2004).

11 See *Pope & Talbot* (supra note 10), par. 58 *et seq.*; *Mondev v. United States* (supra note 10), par. 125; *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Final Award of Jan. 9, 2003, par. 179; see also *Choudhury*, Evolution or Devolution? – Defining Fair and Equitable Treatment in International Investment Law, 6 J. World Inv. & Trade 297 (2005).

ary interpretation also levels differences between treaty law and custom concerning the fair and equitable treatment standard.

This paper attempts to contribute to the on-going debate on rule- and decision-making of investment tribunals with a specific view to the tribunals' construction and application of fair and equitable treatment. The task in the context of this paper does, however, not consist in exhaustively describing the facts of each case and the conclusions drawn by arbitral tribunals; the arbitral jurisprudence on fair and equitable treatment has been accurately and extensively discussed in a number of scholarly contributions.[12] Instead, the paper focuses on outlining the elements arbitral tribunals attribute to fair and equitable treatment in a more conceptual way and attempts to provide a general framework of analysis for the standard's application and interpretation.

In Part II, the paper takes a critical look at the way arbitral tribunals interpret and apply fair and equitable treatment and points to some shortcomings in the arbitral jurisprudence resulting mainly from the standard's considerable vagueness. Part III subsequently aims at clarifying the normative content of fair and equitable treatment and outlines a methodology for the application of fair and equitable treatment to the circumstances of a case submitted to arbitration. This should promote predictability in and uniformity of the standard's interpretation and thus its acceptance by states and investors.

The paper shows how international tribunals have developed certain sub-elements of fair and equitable treatment that appear in recurrent fashion in arbitral jurisprudence and argues that these elements can be understood as and united under the concept of the rule of law (*Rechtsstaat* in the German, *état de droit* in the French tradition). The underlying assumption of such an approach is that the fair and equitable treatment standard has an independent and genuine normative content that is different from other rights granted in international investment treaties. Understanding fair and equitable treatment in such a fashion attributes to the standard a quasi-constitutional function that serves as a yardstick for the exercise of the host states' administrative, judicial or legislative activity vis-à-vis foreign investors. In this perspective, the arbitral jurisprudence does not appear as a fragmented and disordered aggregate of awards but as an expression of the continuous emergence of a global regime that governs foreign investment and the conduct of host states relating to it. Conceptualizing fair and equitable treatment as an embodiment of the rule of law mainly relies on a comparative public law approach that takes a cross-view of the restrictions of governmental activity in domestic legal systems that embrace the concept of the rule of law.

Conversely, the appropriate methodology for concretizing fair and equitable treatment the paper suggests, consists in a comparative method that attempts to ex-

12 See for recent attempts to sum up the jurisprudence *Yannaca-Small* (supra note 6), p. 13 *et seq.*; *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297 (2005); *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357 (2005); *Dolzer* (supra note 8), 39 Int'l Law. 87 (2005).

tract general principles from domestic legal systems and other international legal regimes that embrace an institutional design prescribing rule of law standards for the exercise of governmental power in administrative and judicial proceedings and legislation. At the same time, a comparative approach to fair and equitable treatment illustrates the tension between the rule of law as a legal value and competing public interests that require a proportionate balance. It underscores that fair and equitable treatment cannot be understood as an absolute guarantee but rather as a principle that allows for a balance between investment protection and the host state's public interest.

This understanding of fair and equitable treatment can, however, not only be used as a conceptual explanation of the bulk of the arbitral jurisprudence, but can be grounded in the normative framework contained in international investment treaties, above all the treaties' object and purpose. Part IV therefore provides an analysis of the economics of international investment treaties and shows the positive effects the adoption of the concept of the rule of law has on the behavior of foreign investors, thus promoting foreign investment and economic growth in host countries.

B. Shortcomings in Arbitral Practice Relating to Fair and Equitable Treatment

Arbitral tribunals seem generally ill-equipped in tackling the interpretative conundrum posed by the vagueness of the fair and equitable treatment standard. Tribunals do not only regularly criticize that the standard is not further defined and clarified in investment agreements,[13] they have also not achieved to develop a uniform methodology in order to determine whether specific host state conduct violates fair and equitable treatment.[14] The main reason for this is that traditional interpretative approaches applying Articles 31 and 32 of the Vienna Convention on the Law of Treaties,[15] either directly or as an expression of the customary international law of treaty

13 See *Alex Genin, Eastern Credit Limited, Inc. and A. S. Baltoil v. The Republic of Estonia*, ICSID Case No ARB/99/2, Award of June 25, 2001, par. 367: "the exact content of this standard is not clear"; *Consortium R.F.C.C. v. Royaume du Maroc*, ICSID Case No. ARB/00/6, Sentence Arbitrale of Dec. 22, 2003, par. 51: "Il n'existe pas de définition précise du traitement just et équitable dans le droit des traités"; *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award of Sept. 2, 2001, par. 292: "[T]here is no further definition of the notion of fair and equitable treatment in the Treaty."; *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8, Award of May 12, 2005, par. 273: "The Treaty, like most bilateral investment treaties, does not define the standard of fair and equitable treatment."

14 Criticizing the lack of a uniform methodology, for example, *Kantor*, Fair and Equitable Treatment: Echoes of FDR's Court-Packing Plan in the International Law Approach Towards Regulatory Expropriation, 5 The Law and Practice of International Courts and Tribunals 231 (2006).

15 U.N. Doc. A/CONF.39/27 (1969), 1155 U.N.T.S. 331.

interpretation,[16] are hardly able to clarify the meaning of fair and equitable treatment. The vagueness of the standard goes beyond the commonplace assertions in legal theory that law is inherently vague and indeterminate when it comes to the application of abstract standards to concrete cases. Vagueness and indeterminacy of fair and equitable treatment are not a matter of the penumbra of a rule in the *Hartian* sense or the edges of the rule's frame in the *Kelsenian* sense, but concern the very core of the provision. It does not have a consolidated and conventional core meaning that can easily be applied. Apart from consensus on the fact that fair and equit-able treatment constitutes a standard that is independent from the domestic legal order and does not require actions in bad faith by host states,[17] it is hardly substantiated by state practice or elucidated by *travaux preparatoires* and difficult to narrow down by traditional means of interpretation.

An interpretation of the ordinary meaning may replace the terms "fair and equitable" with similarly vague and empty phrases such as "just", "even-handed", "unbiased" or "legitimate",[18] but does not succeed in clarifying its normative content.[19] In particular, the semantics of fair and equitable treatment do not clarify as against which standard "fairness and equitableness" has to be measured. It could equally refer to notions of equality or substantive justice, or to less grand notions of procedural due process.

Likewise, a plain teleological interpretation hardly provides more specific meaning even if the purpose of international investment treaties points to the protection and promotion of foreign investment and the deepening of the mutual economic relations between the contracting states.[20] Although this narrows down the possible understandings of fair and equitable treatment to an economic framework, a purposive interpretation does not enable tribunals to directly translate the broad language into specific guarantees for foreign investors in the sense of hard and fast rules. In particular, it is difficult to foresee and estimate whether a specific interpretation of an international investment treaty will actually encourage investment flows or whether, on the contrary, an interpretation that may be too onerous for host states

16 See only *Case Concerning the Territorial Dispute (Libyan Arab Jamahiriya v. Chad)*, Judgment of Feb. 13, 1994, ICJ Reports 1994, 21, par. 41; *Case Concerning Oil Platforms (Islamic Republic of Iran v. United States of America)*, Judgment of Dec. 12, 1996, ICJ Reports 1996, 803, par. 23; *Case Concerning Kasikili/Sedudu Island (Botswana v. Namibia)*, Judgment of Dec. 13, 1999, ICJ Reports 1999, 1045 par. 18.

17 Concerning the independence of fair and equitable treatment from domestic law *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005); on the independence from bad faith *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 384 *et seq*. (2005).

18 *Cf. MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award of May 25, 2004, par. 113.

19 It rather confirms that a terminological approach does not succeed in substantiating and clarifying what fair and equitable refers to. In this sense *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Partial Award of Mar. 17, 2006, par. 297; differently *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005).

20 See on the object and purpose of investment treaties and the statements contained in their preambles *Dolzer/Stevens*, Bilateral Investment Treaties, p. 11 *et seq.*, 20 *et seq.* (1995).

will have the effect of chilling the investment climate due to host states admitting less foreign investment.[21]

The traditional methods of treaty interpretation therefore prove to be relatively ineffective in clarifying the meaning of fair and equitable treatment. Understandably, investment tribunals do not follow a uniform methodology.[22] Some tribunals follow an approach that extensively describes the facts of a case and simply characterizes them as a violation of fair and equitable treatment.[23] The problem with this approach is that it does not elucidate the normative content of fair and equitable treatment and leaves the legal reasoning underlying the decision in the obscure. Other tribunals simply posit an abstract standard as part of fair and equitable treatment and subsequently subsume the facts of the case under this standard.[24] While this is closer to the traditional legal syllogism, the tribunals nevertheless fail to properly justify how they ground these abstract standards in fair and equitable treatment. Finally, various tribunals apply fair and equitable treatment with a strong reference to prior arbitral jurisprudence.[25] This approach is critical in two respects. First, treating arbitral decisions as precedent in international law is problematic;[26] secondly, the awards face the criticism that earlier decisions have themselves applied a problematic methodology in terms of failing to grasp the normative content of fair and equitable treatment.

By failing to establish a clear normative, i. e. prescriptive, content of fair and equitable treatment, arbitral tribunals run the risk of facing the reproach that they handle the standard as a malleable tool of *ex post facto* control of host states' meas-

21 Accordingly, the Tribunal in *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award of Oct. 12, 2005, par. 52 warned that a teleological interpretation should not simply lead to an interpretation of bilateral investment treaties *in dubio pro investore*: "While it is not permissible, as is too often done regarding BITs, to interpret clauses exclusively in favour of investors, here such an interpretation is justified." (emphasis added).

22 See *Dolzer* (supra note 8), 39 Int'l Law. 87, 93 *et seq.* (2005) (discerning the three lines of reasoning subsequently addressed).

23 See, for example, *Mondev v. United States* (supra note 10), par. 118, stressing that "[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case".

24 See, for example, *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL/NAFTA, Partial Award of Nov. 13, 2000, par. 134.

25 See for example *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of 30 April 2004, par. 89 *et seq.*

26 Under general international law no doctrine of *stare decisis* exists, see Articles. 38(1)(d) and 59 of the Statute of the International Court of Justice; see also *Verdross/Simma*, Universelles Völkerrecht, p. 397 *et seq.* (3rd ed. 1984). This general observation also holds true in the investment arbitration context. Explicitly in this sense Art. 1136(1) NAFTA: "An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case." See also *Schreuer*, The ICSID Convention: A Commentary, Art. 53 par. 15 (2001) (noting that in the preparatory works for the ICSID Convention nothing implies the applicability of a *stare decisis* rule). Art. 53(1) ICSID-Convention that provides that "[t]he award shall be binding on the parties […]" can therefore be read as "binding *only* on the parties".

ures based on the arbitrators' personal conviction and understanding about what is fair and equitable. The assumption that personal convictions, instead of prescriptive legal standards, play a major role in applying fair and equitable treatment is nourished by the frequent reference to treatment that "shocks, or at least surprises, a sense of juridical propriety"[27] as a yardstick for the standard's application.[28]

Similarly, legal scholarship has not provided much conceptual guidance.[29] Like arbitral tribunals, commentators have not developed a definition or a methodological tool for concretizing fair and equitable treatment. Above all, they have not attempted to unite the vast jurisprudence under a comprehensive concept in order to give a fuller normative explanation of the standard's content. Mostly, they concede that no agreement on the exact meaning of the principle exists[30] and largely confine themselves to describing the existing case law in order to extract contextual elements of fair and equitable treatment[31] or attribute to it the function of a gap-filling device for judging host state conduct that cannot be subsumed under other, possibly more precise, investment treaty guarantees.[32] Some commentators therefore suggest that fair and equitable treatment constitutes "an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules ne-

27 See for example *Técnicas Medioambientales Tecmed S. A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003, par. 154 (quoting the decision of the International Court of Justice in *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment of July 20, 1989, ICJ Reports 1989, p. 15, par. 128). See for a criticism of the ICJ's test for arbitrariness in the *ELSI* case *Hamrock*, The ELSI Case: Toward an International Definition of "Arbitrary" Conduct, 27 Tex. Int'l L. J. 837, 849 *et seq.* (1992) (highlighting the prevalence of subjective elements in the Court's test).

28 See *UNCTAD* (supra note 8), p. 10 (noting the "inherently subjective" trait of the concepts of fairness and equitableness); see also *Yannaca-Small* (supra note 6), p. 2 *et seq.* (mentioning the concern of "a number of governments […] that, the less guidance is provided for arbitrators, the more discretion is involved and the closer the process resembles decisions *ex aequo et bono, i.e* [sic] based on the arbitrators' notions of 'fairness'and 'equity'.").

29 See also *Thomas*, Reflections on Art. 1105 NAFTA: History, State Practice and the Influence of Commentators, 17 ICSID Rev. – Foreign Inv. L. J. 21, 51 *et seq.* (2002). (warning to attach too much weight to the opinions of commentators).

30 *Dolzer* (supra note 8), 39 Int'l Law. 87, 88 (2005) (noting that "a review of some attempts at defining the standard may invite such thinking inasmuch as the approach is so general in nature that the clause may appear to amount to a catch-all provision which may embrace a very broad number of governmental acts"); *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 364 (2005); *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297, 298 (2005).

31 *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 364 *et seq.* (2005) (stressing the specific fact situations considered as a violation of fair and equitable treatment); *Choudhury* (supra note 11), 6 J. World Inv. & Trade 297, 316 *et seq.* (2005) (providing a working definition of fair and equitable treatment that relies on the acceptance of several sub-elements of the standard in arbitral jurisprudence); see also *Thomas* (supra note 29), 17 ICSID Rev. – Foreign Inv. L. J. 21, 59 *et seq.* (2002); *Sornarajah*, The International Law of Foreign Investment, p. 332 *et seq.* (2nd ed. 2004).

32 *Dolzer* (supra note 8), 39 Int'l Law. 87, 90 (2005). Similarly *Mann*, British Treaties for the Promotion and Protection of Investments, 52 Brit. Yb. Int'l L. 241, 243 *et seq.* (1981) (understanding fair and equitable as an "overriding duty").

cessary to achieve the treaty's object and purpose in particular disputes".[33] Similarly, other commentators support the view that the interpretative problems posed by the principle's vagueness should be solved by simply letting tribunals do the work in developing more precise elements of fair and equitable treatment.[34]

It is, however, questionable whether states intended such a broad delegation of powers to international tribunals.[35] In addition, shifting the responsibility of concretizing the meaning of fair and equitable treatment to arbitral tribunals is problematic. It does not only fail to meet the need for further guidance regularly uttered by some tribunals themselves. More importantly, it is unsatisfactory from the perspective of host states that need to evaluate the way they exercise public authority without having to pay damages for the violation of investment treaties.[36] Likewise, it is unsatisfactory from the perspective of foreign investors who desire a stable and predictable investment climate and need to know beforehand against which political risks and government interferences they are protected by the respective investment treaty. Unpredictable, or worse arbitrary, outcomes of arbitration proceedings will not only dissatisfy the parties involved, but may overall chill the efficiency of investment arbitration and the promotion of foreign investment.

A missing conceptual understanding of fair and equitable treatment may also lead to inconsistent decisions in the field of investment protection, possibly lessening the stability and predictability necessary for foreign investment and fostering the fragmentation of international investment law. A theoretic approach to the normative content of fair and equitable treatment may, therefore, not only clarify the conceptual foundations of the standard but is also crucial in order to generate a sustainable understanding of the rights and obligations of investors and host states that are critical to the very basis of international investment protection. With respect to fair and equitable treatment a clearer delineation between investors' rights and state sovereignty is thus needed.

33 *Brower*, Investor-State Disputes under NAFTA: The Empire Strikes Back, 40 Columb. J. Transnat'l L. 43, 56 (2003). Similarly *Franck* (supra note 2), 73 Fordham L. Rev. 1521, 1589 (2005); *Vandevelde*, United States Investment Treaties: Policy and Practice, p. 76 (1992). See also *Dolzer* (supra note 8), 39 Int'l Law. 87, 89 (2005) (suggesting that states deliberately included this general standard as a gap-filling clause).

34 See for example *Schreuer* (supra note 7), 6 J. World Inv. & Trade 357, 365 (2005) (explaning that fair and equitable treatment "is susceptible of specification through judicial practice".); *Dolzer* (supra note 8), 39 Int'l Law. 87, 105 (2005) (concluding that the task with respect to fair and equitable treatment consists in "developing a body of jurisprudence tailored to the specific structures of foreign investment and acceptable to investors, the host state and the home state".).

35 *Porterfield* (supra note 1), 27 U. Pa. J. Int'l Econ. L. 79, 103 *et seq.* (2006). For the contrary view see supra note 33.

36 Alternatively, host states may even abstain from regulation due to this insecurity. International investment treaties would then result in a "regulatory chill", possibly even in areas where regulation is not only necessary but even in the interest of foreign investors. In this sense see *Franck*, Occidental Exploration & Production Co. v Republic of Ecuador, 99 A.J.I.L. 675, 678 (2005).

C. Fair and Equitable Treatment as an Embodiment of the Rule of Law

In this chapter the paper presents an attempt to provide a normative framework of analysis for the interpretation and application of fair and equitable treatment. The argument forwarded is that fair and equitable treatment should properly be understood as an embodiment of the concept of the rule of law (or *Rechtsstaat* in the German, *état de droit* in the French tradition). The rule of law is a wide-spread concept of positive law that can be found with similar characteristics in most legal systems that adhere to liberal constitutionalism.[37] Relying on a common tradition,[38] the main thrust of the rule of law is the aspiration to subject public power to legal control[39] and can be paraphrased with the words of *F. A. Hayek*: "stripped of all technicalities this means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge".[40]

The rule of law primarily refers to the formal quality of law as providing guidance for human affairs and comprises the institutional aspiration that government has to use law as a means of exercising power.[41] First, the rule of law translates into procedural requirements for the deployment of legal processes[42] and mandates that "individuals whose interests are affected by the decisions of […] officials have certain rights", such as "the right to a hearing before a decision is made, the right to have the decision made in an unbiased and impartial fashion, the right to know the basis of the decision so that it can be contested, the right to reasons for the official's decision, and the right to a decision that is reasonably justified by all relevant legal and factual considerations."[43] Hence, the rule of law requires that the affected individual is recognized as a subject with certain rights which have to be taken into account in the decision making process of public authorities. In addition to the recognition of procedural rights, the rule of law is often also at the origin of the idea of

37 See *Schulze-Fielitz*, in: *Dreier* (ed.), Grundgesetz – Kommentar, Art. 20 par. 5 *et seq.* (vol. II 1998).

38 See on the development of the rule of law against its politico-philosophical background *Tamanaha*, On the Rule of Law – History, Politics, Theory (2004).

39 *Dyzenhaus*, The Rule of (Administrative) Law in International Law, 68 Law & Contemp. Probs. 127, 130 (2005); similarly *Waldron*, Is the Rule of Law an Essentially Contested Concept (in Florida)?, 21 Law & Philosophy 137, 158 (2002); *Hesse*, Der Rechtsstaat im Verfassungssystem des Grundgesetzes, in: *Forsthoff* (ed.), Rechtsstaatlichkeit und Sozialstaatlichkeit, p. 557, 560 *et seq.* (1968). As such, it should also be distinguished from other concepts of good and desirable government, such as human rights, democracy or justice; see *Raz*, The Rule of Law and its Virtue, 93 L. Quart. Rev. 195 *et seq.* (1977).

40 *Hayek*, The Road to Serfdom, p. 54 (1944).

41 See *Fallon*, "The Rule of Law" as a Concept in Constitutional Discourse, 97 Columb. L. Rev. 1, 14 *et seq.* (1997) on the formalist ideal in the rule of law.

42 See *Fallon* (supra note 41), 97 Columb. L. Rev. 1, 18 *et seq.* (1997) on the legal process ideal understanding of the rule of law.

43 *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 129 (2005).

proportionality, referring to the proper balance that has to be struck between the interests of the individual and competing public interests.[44] Secondly, the rule of law has implications for the institutional design of government. It mandates a basic separation of powers and the possibility to seek review of public acts by an independent judiciary.[45] Essentially it is this primarily formal understanding of the rule of law that prevails in many domestic legal traditions.[46]

In this sense, fair and equitable treatment can be understood as a rule of law standard that the legal systems of host states have to embrace as a standard for the treatment of foreign investors. While this may not seem much of a concretization given different historic developments and thrusts of the rule of law in different national legal systems and in light of the fact that the exact content and the requirements of the rule of law are often debated,[47] it nevertheless seems to constitute a viable approach to explain the normative content of fair and equitable treatment. A comparative analysis of municipal law reveals certain common ideas and standards that can be transferred to the international level and help to identify the paradigm features a state has to conform to in order to comply with the notion of "fairness and equitableness" in international investment law. Arguably, a comparative approach also constitutes a suitable methodological approach for the standard's interpretation and renders the outcome of investment disputes more predictable.

I. Principles Derived from Fair and Equitable Treatment

In view of the existing arbitral jurisprudence on fair and equitable treatment, seven specific normative principles can be discerned that occur in recurring fashion in the reasoning of arbitral tribunals and are presented as elements of fair and equitable treatment. These principles are (1) the requirement of stability, predictability and consistency of the legal framework, (2) the principle of legality, (3) the protection of investor confidence or legitimate expectations, (4) procedural due process and denial of justice, (5) substantive due process or protection against discrimination and arbitrariness, (6) the requirement of transparency and (7) the requirement of reasonable-

44 See on this thrust that has been developed particularly in the German tradition and has been taken up in the reasoning of the European Court of Human Rights and the European Court of Justice infra note 110.

45 *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 130 *et seq.* (2005).

46 See on the primarily formal tradition in Germany for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 13 *et seq.* Similarly, the due-process clause of the U.S. Constitution has mainly found a procedural interpretation; see *Shell*, Rechtsstaatlichkeit und Demokratie in den USA, in: *Tohidipur* (ed.), Der bürgerliche Rechtsstaat, p. 377 *et seq.* (1978). See also *Kantor* (supra note 14) on the decline of the substantive understanding of due process in the U.S. Supreme Court jurisprudence and its emphasis on procedure.

47 See only *Waldron* (supra note 39), 21 Law & Philosophy 137 (2002).

ness and proportionality. These principles also figure prominently as sub-elements or expressions of the broader concept of the rule of law in domestic legal systems.

1. Stability, Predictability, Consistency

International investment treaties in general seek to enhance the stability of the investment climate and reduce political risk.[48] Accordingly, one aspect that is recurrently invoked by investment tribunals as part of fair and equitable treatment is the concept of stability, predictability and consistency of the host state's legal framework. Based on the preamble in the United States-Argentina BIT that provides "that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources", the Tribunal in *CMS v. Argentina*, for example, found that "there can be no doubt […] that a stable legal and business environment is an essential element of fair and equitable treatment".[49] On this basis, the Tribunal found that the Argentine emergency legislation in 2001/2002 which entirely and permanently transformed the legal framework of the privatized gas sector violated fair and equitable treatment.[50] Likewise, the Tribunal in *OEPC v. Ecuador* held that "[t]he stability of the legal and business framework is thus an essential element of fair and equitable treatment".[51]

Similarly, the predictability of the legal framework governing the activity of foreign investors is frequently considered as an element of fair and equitable treatment. The Tribunal in *Metalclad v. Mexico*, for instance, based its finding of a violation of Art. 1105(1) NAFTA *inter alia* on the argument that Mexico "failed to ensure a […] predictable framework for Metalclad's business planning and investment".[52] The predictability of the legal framework was also evoked by the Tribunal in *Tecmed v. Mexico* when stressing that the foreign investor needs to "know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations".[53] Accordingly, a lack

48 *Rubins/Kinsella*, International Investment, Political Risk and Dispute Resolution, p. 1 *et seq.* (2005). See also *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction of June 17, 2003, par. 28 (regarding bilateral investment treaties as one of the "expressions of the search for stability and legal certainty" in international economic relations).

49 *CMS v. Argentina* (supra note 13), par. 274.

50 See for a fuller analysis of the case *Schill*, From Calvo to CMS: Burying an International Law Legacy – Argentina's Currency Reform in the Face of Investment Protection: The ICSID Case CMS v. Argentina, 3 SchiedsVZ/German Arb. J. 285 (2005).

51 See *Occidental Exploration and Production Company (OEPC) v. The Republic of Ecuador*, UNCITRAL, LCIA Case No. UN3467, Final Award of July 1, 2004, par. 183.

52 See *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of Aug. 30, 2000, par. 99.

53 *Tecmed v. Mexico* (supra note 27), par. 154.

of clarity of the legal framework or excessively vague rules can violate fair and equitable treatment.[54]

Finally, the concept of consistency plays an important role in the arbitral jurisprudence on fair and equitable treatment. The Tribunal in *Lauder v. Czech Republic*, for example, stressed this connection when it underscored that fair and equitable treatment could be violated if domestic agencies acted inconsistently in applying domestic legislation.[55] Similarly, in *MTD v. Chile* the Tribunal found a violation of fair and equitable treatment due to "the inconsistency of action between two arms of the same Government *vis-à-vis* the same investor".[56] Likewise, the Tribunal in *Tecmed v. Mexico* emphasized the need of consistency in the decision-making of a national agency in order to conform to fair and equitable treatment.[57]

These lines of argument run parallel to one of the central elements the concept of the rule of law is associated with in domestic legal systems: legal certainty and legal security (*Rechtssicherheit*).[58] This element of the rule of law refers to the core aspect of normativity of law that allows individuals to adapt their behavior to the requirements of the legal order and form stable social relationships. Especially in the commercial context stability is a critical component for long-term investment. Legal security requires a certain stability of the legal order, legal certainty calls for predictable and understandable rules and their consistent application. This interpretation notably conforms with the object and purpose of international investment treaties, as stability, predictability and consistency are necessary for investors in order to plan and calculate their investment and adjust to the legal framework in the host country.

Yet, one has to be aware that stability and predictability of domestic law can only relate to the normal deployment of governmental law- and policy-making and, parallel to the function of the rule of law in domestic constitutional law, should not be

54 See for example *OEPC v. Ecuador* (supra note 51), par. 184 (criticizing the vagueness of a change in the domestic tax law that did not "provid[e] any clarity about its meaning and extent").

55 *Lauder v. Czech Republic* (supra note 13), par. 292 *et seq.* In the case at hand, a regulatory agency had commenced an administrative proceeding against a television broadcasting company for non-compliance with the domestic Media Law due to allegedly unauthorized broadcasting without the necessary license. The Tribunal declined to find a violation of fair and equitable treatment by arguing that there were understandable grounds why the agency had initiated administrative proceedings. It also pointed out that inconsistent conduct of domestic agencies could not be assumed if the conduct consisted in enforcing domestic law, unless there was a specific undertaking to refrain from doing so.

56 *MTD v. Chile* (supra note 18), par. 163.

57 *Tecmed v. Mexico* (supra note 27), par. 154, 162 *et seq.* See also *OEPC v. Ecuador* (supra note 51), par. 184.

58 As such it is recognized, mostly as a constitutional standard, in many domestic legal systems. See for its implementation in the German Constitution *Schulze-Fielitz* (supra note 37), Art. 20 par. 117 *et seq.*; see *Fallon* (supra note 41), 97 Columb. L. Rev. 1, 14 *et seq.* (1997) with references to U.S. constitutional practice; more generally, see also *Raz* (supra note 39), 93 L. Quart. Rev. 195, 198 (1977).

understood as an absolute requirement that would allow foreign investors to be effectively excluded from regulatory changes in the host state.[59] Accordingly, stability and predictability should not be misunderstood as a guarantee that the legal framework will never change or even serve as a business guarantee to investment projects.[60] Likewise, the stability of the legal order will vary with the circumstances host states might have to react to: a serious crisis or even an emergency situation may call for different reactions than the deployment of public power in the normal course of things.[61] Concerning consistency, one should be aware that domestic regulatory frameworks are never completely free of inconsistencies.[62] A violation of this sub-element should therefore be handled in a prudent manner.

2. Legality

Fair and equitable treatment has also been interpreted by arbitral tribunals as including the principle of legality. In various cases tribunals based their assessment of fair and equitable treatment on an appreciation of whether domestic actors obeyed national legal provisions governing the conduct in question. Although tribunals diverge on the question to which extent the correct application of domestic law is subject to scrutiny by arbitral tribunals, their jurisprudence is consistent in holding that a violation of domestic law can constitute a violation of fair and equitable treatment.[63] This obligation applies to the domestic judiciary as well as to adminis-

59 In this sense also *Dolzer* (supra note 8), 39 Int'l Law. 87, 105 (2005).

60 See only *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award of Nov. 13, 2000, par. 64 ("emphasiz[ing] that Bilateral Investment Treaties are not insurance policies against bad business judgments"); *Marvin Roy Feldman Karpa v. The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award of Dec. 16, 2002, par. 112 (noting "that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c)").

61 See, for example, the *ELSI Case* (supra note 27), par. 74: "Clearly the right [to control and manage a company] cannot be interpreted as a sort of warranty that the normal exercise of control and management shall never be disturbed. Every system of law must provide, for example, for interferences with the normal exercise of rights during public emergencies and the like."

62 *Franck* (supra note 36), 99 A.J.I.L. 675, 678 (2005).

63 Although some tribunals held that a violation of domestic law in itself is not a violation of fair and equitable treatment, such as *ADF v. United States* (supra note 11) (stressing explicitly that "something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1)"), I rather do not interpret this as requiring an additional or qualified violation of domestic law but instead see this as a question of the standard of review of international tribunals that may depend on the procedural posture of the case, the applicable law, the question whether local remedies were exhausted etc.

trative agencies, and has even been alluded to concerning the question whether the activity of the domestic legislator was in conformity with the national constitution.[64]

In *Metalclad v. Mexico*, for instance, one factor for the Tribunal's finding of a violation of fair and equitable treatment was the apparent misapplication of a construction law by a local municipality.[65] Similarly, in *Pope & Talbot v. Canada* the Tribunal relied on the lack in competence of a domestic agency for initiating administrative proceedings against a foreign investor. Instead of relying "on naked assertions of authority and on threats that the Investment's allocation could be cancelled, reduced or suspended for failure to accept verification", the Tribunal emphasized that "before seeking to bludgeon the Investment into compliance, the SLD [i. e. the administrative agency] should have resolved any doubts on the issue and should have advised the Investment of the legal basis for its actions".[66] Here, the failure to produce a legal basis for the administrative proceedings under domestic law was therefore taken into account as one aspect for the violation of fair and equitable treatment.

Fair and equitable treatment was also interpreted to include an obligation to apply domestic law. In *GAMI Investments, Inc. v. Mexico* the Tribunal deduced from fair and equitable treatment an obligation to not only abide by but also to enforce existing provisions of national law.[67] Similarly, in *Tecmed v. Mexico* the Tribunal underscored that host states have to make use of "the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments".[68]

The connection between fair and equitable treatment and the principle of legality does, however, not only become apparent when domestic decision-makers violate municipal laws. On the contrary, the observance of domestic legal rules is often relied upon by tribunals in order to deny a violation of fair and equitable treatment. In *Noble Ventures v. Romania*, for example, the Tribunal observed that certain bankruptcy proceedings "were initiated and conducted according to the law and not against it"[69] and accordingly denied a violation of fair and equitable treatment. Similarly, in *Lauder v. Czech Republic* the Tribunal emphasized that a violation of fair and equitable treatment was usually excluded in case of a "regulatory body taking the necessary actions to enforce the law".[70]

64 See *CMS v. Argentina* (supra note 13), par. 119 *et seq.*

65 *Metalclad v. Mexico* (supra note 52), par. 93.

66 *Pope & Talbot, Inc. v. The Government of Canada*, UNCITRAL/NAFTA, Award on the Merits of Phase 2 of April 10, 2001, par. 174 *et seq.*

67 *GAMI Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL/NAFTA, Final Award of Nov. 15, 2004, par. 91: "It is in this sense that a government's failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105."

68 *Tecmed v. Mexico* (supra note 27), par. 154.

69 *Noble Ventures v. Romania* (supra note 21), par. 178.

70 *Lauder v. Czech Republic* (supra note 13), par. 297.

The decisions therefore clearly consider the principle of legality as an element of fair and equitable treatment. The principle of legality also finds its counterpart in rule of law concepts that encompass the requirement that public power derives its authority from a legal basis and is exercised along the lines of pre-established procedural and substantive rules.[71] The principle of legality should, however, not distract from the fact that fair and equitable treatment does not simply buttress the application of domestic law and provide a claim of the foreign investor against the host state to apply its domestic law correctly. Rather, fair and equitable treatment remains an independent standard of international law against which the domestic legal order is measured.

3. Protection of Confidence and Legitimate Expectations

While the principle of legality is closely related to the idea that the executive and the judicial branch of government have to obey the law enacted by the legislator, legal rules are only able to have a stabilizing function for social relationships and create the basis of an environment conducive to long-term investment when they are applied according to how a reasonable investor would expect them to be applied. The ordering function of law therefore requires taking into account the perceptions of the law's subject and their expectations vis-à-vis government activity.

Accordingly, the concept of legitimate expectations is emerging as another prominent sub-element of fair and equitable treatment in arbitral practice. The Tribunal in *Saluka v. Czech Republic* referred to the concept of legitimate expectations even as "the dominant element of that standard".[72] Its existence can also be traced as an element of the rule of law in domestic legal systems[73] and as a concept of general international law.[74] Its main thrust in this context is the protection of confidence against administrative and legislative conduct. In this sense, the Tribunal in

71 In the German constitutional tradition this element of the rule of law is designated as "Gesetzmäßgkeit der Verwaltung" and "Vorrang des Gesetzes". See *Schulze-Fielitz* (supra note 37), Art. 20 par. 83 *et seq.*

72 *Saluka v. Czech Republic* (supra note 19), 301.

73 See *Dyzenhaus* (supra note 39), 68 Law & Contemp. Probs. 127, 133 *et seq.* (2005) with reference to case law in Australia and the UK; *Schulze-Fielitz* (supra note 37), Art. 20 par. 134 *et seq.* concerning German Constitutional Law; *Schønberg*, Legitimate Expectations in Administrative Law (2000) on English, French and EC/EU law; *Dyer*, Legitimate Expectations in Procedural Fairness after Lam, in: *Groves* (ed.), Law and Government in Australia, p. 184 *et seq.* (2005) on Australian law; see also *Woehrling*, Le Principe de Confiance Légitime dans la Jurisprudence des Tribunaux, in: *Bridge* (ed.), Comparative Law Facing the 21st Century, p. 815 *et seq.* (1998) summarizing a comparative study by the XVth International Congress of Comparative Law, Bristol/UK in 1998.

74 See *Müller*, Vertrauensschutz im Völkerrecht (1971). See more specifically in the context of the law of expropriation of aliens *Dolzer*, New Foundations of the Law of Expropriation of Alien Property, 75 A.J.I.L. 553, 579 *et seq.* (1981).

Tecmed v. Mexico held that fair and equitable treatment requires "provid[ing] to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment".[75] Similarly, the Tribunal in *International Thunderbird Gaming Corporation v. Mexico* explained that "the concept of 'legitimate expectations' relates […] to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages".[76]

Legitimate expectations can result from a number of actions that are attributable to the host state.[77] In the first place, a breach of legitimate expectations will come into play if there is conduct "in breach of representations made by the host State which were reasonably relied on by the [investor]".[78] They can result, for example, from opinions and statements released by administrative agencies about the application of domestic law.[79]

It is, however, not necessary that expectations were induced by administrative action that was individually directed towards a foreign investor. Legitimate expectations can also originate from the provisions of the general regulatory framework which a host state has set into place[80] as long as the confidence the framework ge-

75 *Tecmed v. Mexico* (supra note 27), par. 154. The Tribunal's approach was also taken up in a number of other cases. See *ADF v. United States* (supra note 11), par. 189; *MTD v. Chile* (supra note 18), par. 114 *et seq.*; *OEPC v. Ecuador* (supra note 51), par. 185; *CMS v. Argentina* (supra note 13), par. 279; *Eureko B.V. v. Republic of Poland*, Partial Award of Aug. 19, 2005, par. 235, 241.

76 *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL/NAFTA, Arbitral Award of Jan. 26, 2006, par. 147 (internal citation omitted).

77 See on the connection between the expectations and government conduct *ADF v. United States* (supra note 11), par. 189, where the Tribunal declined to find a violation of Art. 1105(1) NAFTA in a case where the claimant argued that existing case law suggested that an agency would have to grant a waiver from a statutory local content requirement, noting that "any expectations that the Investor had with respect to the relevancy or applicability of the case law it cited were not created by any misleading representations made by authorized officials of the U.S. Federal Government but rather, it appears probable, by legal advice received by the Investor from private U.S. counsel."

78 *Waste Management v. Mexico* (supra note 25), par. 98. Similarly *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Partial Award of Sept. 13, 2001, par. 611 (arguing that the Respondent "breached its obligation of fair and equitable treatment by eviscerations of the arrangements in reliance upon which the foreign investor was induced to invest").

79 In *International Thunderbird Gaming v. Mexico* (supra note 76) the investor wanted to set up a gaming business in Mexico and sought a statement of the competent agency as to whether its gaming machines were in conformity with Mexican law that prohibited gambling and luck-related games. The Tribunal did, however, not consider the opinion given by the administrative agency as sufficiently specific so as to form the basis of legitimate expectations. See also *Metalclad v. Mexico* (supra note 52), par. 85 *et seq.* (concerning the violation of fair and equitable treatment pursuant to the (incorrect) statement of a government agency that the permits necessary to start building a waste landfill had been obtained).

80 See *GAMI v. Mexico* (supra note 67), par. 100.

nerated is sufficiently specific. In this context, the concept of legitimate expectations as an element of the rule of law may even restrict the domestic legislator in its decision-making concerning changes of the regulatory framework. This was the case in the dispute in *CMS v. Argentina*, where the regulatory framework the foreign investor relied upon when making his investment was permanently and fundamentally altered at a later stage.[81]

The concept entails, however, the danger that domestic legal orders and the actions of host states are exclusively measured against the expectations of foreign investors. Although the legitimacy of expectations already limits the scope of the concept,[82] it should not be handled as an inflexible and absolute yard-stick. Instead, tribunals should allow for a certain flexibility for host states to react, for example but not exclusively, to emergency situations. Accordingly, the Tribunal in *Eureko v. Poland* suggested that the breach of basic expectations was not a violation of fair and equitable treatment if good reasons existed why the expectations of the investor could not be met.[83] Similarly, the Tribunal in *Saluka v. Czech Republic* specifically warned of the danger of taking the idea of the investor's expectation too literally since this would "impose upon host States' [sic] obligations which would be inappropriate and unrealistic".[84] Instead, the Tribunal set out to balance the investor's legitimate expectations and the host state's interests within a broader proportionality test. It reasoned:

"No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. […]

The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other.

A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to

81 See specifically on the concept of legitimate expectations in the context of this case *Costamagna*, Investors' Rights and State Regulatory Autonomy: the Role of the Legitimate Expectation Principle in the CMS v. Argentina Case, 3 TDM (issue 2, April 2006) p. 6 *et seq.* (available via http://www.transnational-dispute-management.com).

82 See *Saluka v. Czech Republic* (supra note 19), par. 304.

83 See *Eureko v. Poland* (supra note 75), par. 232 *et seq.*

84 *Saluka v. Czech Republic* (supra note 19), par. 304.

rational policies not motivated by a preference for other investments over the foreign-owned investment."[85]

Overall, the concept of legitimate expectations therefore offers sufficient flexibility to reconcile the interests of foreign investors and host states. The aim of achieving a balance between the protection of confidence and legitimate expectations and the public interest can also be mirrored in the concept of protection of confidence under domestic legal systems.[86]

4. Administrative Due Process and Denial of Justice

Several cases interpreted fair and equitable treatment so as to include the concept of due process. Due process, in this context, mainly comes in two forms: administrative and judicial due process.[87] It is thus closely connected to the proper administration of civil and criminal justice.[88] Recently, both an explicit reference to due process and the concept of denial of justice as part of fair and equitable treatment have been included in the treaty practice of the United States. Art. 10.5(2)(a) of the The Dominican Republic – Central America – United States Free Trade Agreement, for instance, stipulates that

"fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world".[89]

Even absent this explicit reference, investment tribunals have interpreted fair and equitable treatment in this way. The Tribunal in *Waste Management v. Mexico*, for instance, defined a violation of fair and equitable treatment as "involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process."[90] Similarly, for the

85 *Saluka v. Czech Republic* (supra note 19), par. 305 *et seq.*

86 See, for example, on the jurisprudence of the German Constitutional Court *Schulze-Fielitz* (supra note 37), Art. 20 par. 139 *et seq.*

87 The national legislator, so far, has not been subjected to any due process notions in investment arbitration. This could, however, be conceivable in the context of legislative expropriations since most BITs explicitly require host states to grant affected investors due process. See *Dolzer/Stevens* (supra note 20), p. 106 *et seq.* (1995).

88 See comprehensibly on the closely related concept of denial of justice in international law *Paulsson*, Denial of Justice in International Law (2005).

89 *The Dominican Republic – Central America – United States Free Trade Agreement*, signed Aug. 5, 2004, available at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section _Index.html. Similar provi sions can be found in a number of other recently concluded and currently negotiated free trade agreement of the United States, see *Kantor* (supra note 14).

90 *Waste Management v. Mexico* (supra note 25), par. 98.

Tribunal in *S.D. Myers v. Canada* fair and equitable treatment, among other elements, included "the international law requirements of due process".[91]

The main thrust of the due process requirement in investment treaty arbitration is to establish procedural rights for investors in administrative proceedings. This was emphasized by the Tribunal in *International Thunderbird Gaming v. Mexico* that held that the proceedings of a government agency "should be tested against the standards of due process and procedural fairness applicable to administrative officials".[92] Fair and equitable treatment is, however, equally relevant for the discharge of judicial proceedings.[93] In this context the standard can be violated "if Claimants were denied access to the courts […] or if the Claimants were treated unfairly in those courts (denial of procedural justice) or if the judgment of those courts were substantively unfair (denial of substantive justice)".[94]

5. Protection against Arbitrariness and Discrimination

The protection of foreign investors against arbitrary and discriminatory treatment also plays a major role in the operation of fair and equitable treatment. While sometimes international investment treaties contain a specific provision prohibiting such treatment, arbitral tribunals also ground this aspect in the concept of fair and equitable treatment. The connection between arbitrariness and the concept of the rule of law has been explicitly drawn by the decision of the International Court of Justice in the *ELSI Case*. Considering whether the requisition by the Mayor of Palermo of a foreign-owned factory in order to prevent its closure and the layoff of around 1000 workers, the Court observed that

"[a]rbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the *Asylum* case, when it spoke of 'arbitrary action' being 'substituted for the rule of law'. It is wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."[95]

Although the case arose under the Friendship, Commerce and Navigation Treaty between the United States and Italy, the decision has been widely accepted as being relevant for the interpretation of fair and equitable treatment in international invest-

91 *S.D. Myers v. Canada* (supra note 24), par. 134.
92 *International Thunderbird Gaming v. Mexico* (supra note 76), par. 200.
93 See *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic*, ICSID Case No. ARB/97/3, Award of Nov. 21, 2000, par. 80; *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of June 26, 2003, par. 132; *Waste Management v. Mexico* (supra note 25), par. 132.
94 *Aguas del Aconquija v. Argentina* (supra note 93), par. 80.
95 *ELSI Case* (supra note 27), par. 128 (internal citations omitted).

ment treaties.[96] The reason for this may be that arbitrary conduct can essentially be regarded as a qualified violation of the requirement to act in accordance with domestic law. Arbitrary conduct therefore can be seen as a sufficient but not as a necessary requirement for the violation of fair and equitable treatment. It can also be linked to the requirement under fair and equitable treatment to act in good faith.[97]

The nexus between fair and equitable treatment and the prohibition of discriminatory treatment has been emphasized in *Loewen v. United States*. Here, the Tribunal stated that fair and equitable treatment is violated by "[a] decision which is in breach of municipal law and is discriminatory against the foreign litigant".[98] Similarly, the Tribunal in *Waste Management v. Mexico* elaborated that "fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice".[99]

Other tribunals suggest drawing a clearer distinction between fair and equitable treatment and the prohibition of discriminatory conduct. They emphasize that "[c]ustomary international law does not […] require that a state treat all aliens (and alien property) equally, or that it treats aliens as favourable as nationals".[100] They only consider a violation of fair and equitable treatment if the investor was "specifically targeted" or if the differential treatment amounted to bad faith.[101]

96 See for example *Alex Genin v. Estonia* (supra note 13), par. 371; *Waste Management v. Mexico* (supra note 25), par. 98; *Noble Ventures v. Romania* (supra note 21), par. 176.

97 See *Waste Management v. Mexico* (supra note 25), par. 138: "A basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means"; *Alex Genin v. Estonia* (supra note 13), par. 367: "Acts that would violate [fair and equitable treatment] would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith." See also *Tecmed v. Mexico* (supra note 27), par. 154.

98 *Loewen v. United States* (supra note 93), par. 135.

99 *Waste Management v. Mexico* (supra note 25), par. 98; similarly *Eureko v. Poland* (supra note 75), par. 233 (finding that the state "acted not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character" and therefore breached fair and equitable treatment). *S.D. Myers v. Canada* (supra note 24), par. 266, also draws a parallel between national treatment and the fair and equitable treatment standard when stating: "Although […] the Tribunal does not rule out the possibility that there could be circumstances in which a denial of the national treatment provisions of the NAFTA would not necessarily offend the minimum standard provisions, a majority of the Tribunal determines that on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well."

100 *Alex Genin v. Estonia* (supra note 13), par. 368; similarly *Methanex Corporation v. United States of America*, UNCITRAL/NAFTA, Final Award of Aug. 3, 2005, Part IV - Chapter C par. 25.

101 *Alex Genin v. Estonia* (supra note 13), par. 369 and 371.

6. Transparency

A few cases have based a violation of fair and equitable treatment on a lack of transparency. The Tribunal in *Metalclad v. Mexico,* for instance, found that the respondent breached Art. 1105 NAFTA because "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment".[102] In a similar manner, the Tribunal in *Tecmed v. Mexico* connected the element of legitimate expectations to the requirement of transparency by stating:

"The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. "[103]

Especially, the decision in *Metalclad v. Mexico* has received major critique for interpreting fair and equitable treatment as including a transparency requirement and has been set aside by the Supreme Court of Columbia exercising jurisdiction under the British Columbia International Arbitration Act for this reason.[104] Yet, the Court seems to have over-interpreted the scope of the transparency requirement the Tribunal deduced from fair and equitable treatment.[105] Indeed, if transparency is considered to mean "that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments […] should be capable of being readily known to all affected investors" and requires the host state "to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws",[106] such an onerous standard risks to "overstretch the position and function of administrative agencies by developing them into consultative units and insurers for the implementation of foreign investment projects".[107]

Yet, a more restrictive reading of the transparency requirement seems equally possible and more closely related to the concept of the rule of law. In the *Tecmed-*

102 *Metalclad v. Mexico* (supra note 52), par. 99 (emphasis added).

103 *Tecmed v. Mexico* (supra note 27), par. 154; similarly *Maffezini v. Spain* (supra note 60), par. 83.

104 See Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation*, 2001 BCSC 644, available via http://www.investmentclaims.com.

105 In addition, it is questionable whether the domestic courts acted in conformity with the provisions of NAFTA when entertaining a claim to set aside a NAFTA award. See on this *Brower*, Investor-State Disputes Under NAFTA: The Empire Strikes Back, 40 Colum. J. Transnat'l L. 43 (2001).

106 *Metalclad v. Mexico* (supra note 52), par. 76 (for both citations).

107 *Schill*, Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case Tecmed, 3 TDM (issue 2, April 2006) p. 15 (available via http://www. transnational-dispute-management.com); for the original German version of this article see *Schill*, Völkerrechtlicher Investitions- und Eigentumsschutz in der ICSID-Entscheidung TECMED, in: 51 Recht der Internationalen Wirtschaft 330 (2005).

case, for example, transparency mainly referred to procedural aspects of administrative law, such as the requirement to give sufficient reasons[108] and the obligation to act in a comprehensible and predictable way.[109] Essentially, these statements only reiterate more general requirement of the rule of law that relate to the procedural position of foreign investors in administrative proceedings. Transparency does therefore not necessarily have to be viewed as an additional substantive requirement, but rather as an instrument of procedurally resolving uncertainty in the domestic law and closely interacts with the burden of proof. As a matter of procedural fairness complete uncertainties of domestic law should not be imposed to the detriment of the foreign investor who is less accustomed to the general legal and political culture of the host state. In that sense it is fully compatible with a procedural understandding of the rule of law and does not impose obligations upon host states to counsel foreign investors or provide them with comprehensive legal advice.

7. Reasonableness and Proportionality

Finally, arbitral tribunals often link fair and equitable treatment to the concept of reasonableness and proportionality. Such criteria also play an important role as part of the rule of law in many domestic legal systems, the law of the European Union

108 See *Tecmed v. Mexico* (supra note 27), par. 123: "administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies." Similarly, *Tecmed v. Mexico*, par. 164.

109 See *Tecmed v. Mexico* (supra note 27), par. 160: "The incidental statements as to the Landfill's relocation in the correspondence exchanged between *INE* and *Cytrar* or *Tecmed* […] cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as *Cytrar's* business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to *Cytrar* from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of *Cytrar*'s operations at the Landfill to another place".

and the jurisprudence of the European Court of Human Rights.[110] Its function, however, mainly consists in controlling the extent to which interferences of host states with foreign investments are permitted. In this light, the Tribunal in *Pope & Talbot v. Canada* repeatedly referred to the reasonableness of the conduct of an administrative agency in order to decline a violation of fair and equitable treatment.[111] The mitigating role of the principle of proportionality has also been applied in the decision in *Saluka v. Czech Republic* as a way to balance the host state's interest in upholding the stability of its banking sector with the expectations of the foreign investor.[112]

Another award that used proportionality as a concept restricting generally permissible interferences with foreign investments is the decision in *Tecmed v. Mexico*. Here, the Tribunal incorporated a proportionality test as a method to distinguish between a compensable indirect expropriation and a non-compensable regulation.[113] In the Tribunal's reasoning an indirect expropriation occurs whenever a restriction of the right to property is disproportionate:

"[T]he Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality. […] There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."[114]

Although integrating proportionality into the principle of fair and equitable treatment allows to a certain extent for a substantive control of host state conduct, the

110 See for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 167 *et seq.* on German constitutional law where the proportionality principle arguably finds its origins in modern positive constitutional law. See also *Ellis* (ed.), The Principle of Proportionality in the Laws of Europe (1999); on proportionality as a principle in EU/EC law *Emiliou*, *The Principle of Proportionality in European Law,* p. 23 et seq. (1996); *Nolte*, General Principles of German and European Administrative Law - A Comparison in Historic Perspective, 191 Mod. L. Rev. 191 (1994); see also *Gunn*, Deconstructing Proportionality in Limitations Analysis, 19 Emory Int'l L. Rev. 465 (2005). Proportionality is also a guiding principle in the interpretation of the European Convention on Human Rights, see *van Dijk/van Hoof*, Theory and Practice of the European Convention on Human Rights, p. 80 *et seq.* (1998). Critical however concerning the scope of the proportionality requirement in U.S. constitutional law in particular concerning criminal law in the context of the Eighth Amendment see *Ristroph*, Proportionality as a Principle of Limited Government, 55 Duke L. J. 263 (2005) with further references; see also on the hesitance in U.S. constitutional law to accept proportiona-lity as a general principle *Jackson*, Ambivalent Resistance and Comparative Constitutionalism: Opening up the Conversation on "Proportionality", Rights And Federalism, 1 U. Pa. J. Const. L. 583 (1999).

111 See *Pope & Talbot v. Canada* (supra note 66), par. 123, 125, 128, 155; see also *MTD v. Chile* (supra note 18), par. 109 with a reference to an expert opinion by *Schwebel*.

112 See above all *Saluka v. Czech Republic* (supra note 19), par. 304 *et seq.*

113 *Schill* (supra note 107), 3 TDM (issue 2, April 2006) p. 9 *et seq.*

114 *Tecmed v. Mexico* (supra note 27), par. 122.

proportionality requirement also clarifies that fair and equitable treatment is not an inflexible standard, but allows for the balancing of the interests of host states and foreign investors. As long as sufficient leeway is given for the implementation of domestic policies and as long as tribunals refrain from using it in order to establish an intrusive standard of review, proportionality constitutes a concept that helps to counter fears about the dominance of investors' rights over the interests of host states. Although the concept of proportionality as part of fair and equitable treatment is still in its infancy, it helps to reconcile the interests of foreign investors with the necessary implementation of regulatory policies by host states.

II. Contextualization of Fair and Equitable Treatment in the Separation of Powers Framework

Although the elements arbitral tribunals have developed in order to concretize the principle of fair and equitable treatment are of a fairly general nature, they can be further concretized in regard of the discharge of public power by the domestic administration, in domestic legal proceedings and national legislation. Fair and equitable treatment, thus, develops into increasingly specific requirements that national legal systems have to incorporate in order to comply with international investment treaties. Fair and equitable treatment therefore assumes a function that is compareable to domestic constitutional law, however with two modifications: it only constitutes a special regime for foreign investors and, only entitling to damages in case the host state violates its treaty obligations, does not assume normative supremacy.

1. Fair and Equitable Treatment and Domestic Administrative Law

National administrative law is particularly prone to the influence of fair and equitable treatment as foreign investors are affected by administrative proceedings at various stages of an investment project, reaching from the application for and issuance of operating licenses to the general regulatory control and supervision of their undertaking. In this context, several sub-elements of the standard establish rule of law components that serve as a yardstick for domestic administrative law. In this context, fair and equitable treatment becomes a *leitmotif* for structuring the relationship between investors and national administrations.[115] The rule of law elements that mainly influence domestic administrative law are the principle of legality, the protection of confidence and the requirement of due process. These elements influence, for example, the structure and process of administrative decision-making, account

115 *Schill* (supra note 107), 3 TDM (issue 2, April 2006) p. 13 *et seq.*

for procedural rights of foreign investors and may limit the exercise of administrative discretion.

a) Administrative Procedure

With respect to administrative procedure, in particular concerning the granting, renunciation or renewal of operating licenses, fair and equitable treatment requires domestic administrations to grant foreign investors a fair hearing, conduct proceedings in a comprehensible way and give reasons for their decisions. The right to a fair hearing and the right to participation in administrative proceedings played a role in the NAFTA case *Metalclad v. Mexico* where the Tribunal found a breach of fair and equitable treatment because the investor was not properly involved. According to the Tribunal the investor should have been given the chance to participate in a meeting of a local town council that discussed whether a construction permit was to be given for the investor's waste landfill.[116] Similarly, the Tribunal in *Tecmed v. Mexico* emphasized the right to a fair hearing as part of fair and equitable treatment in the context of an administrative proceeding that concerned the non-prolongation of an operating license for a waste landfill. It also stated that the standard required the national administration to take decisions about the requests of a foreign investor.[117]

Fair and equitable treatment further obliges the domestic administration to give reasons for their decisions and base them on sufficient factual evidence. The purpose of this requirement is to rationalize the decision-making process and to secure that decisions are taken in accordance with the legal requirements contained in domestic law. Against this backdrop, the Tribunal in *Metalclad v. Mexico* determined that Mexico had breached the fair and equitable treatment standard because the Town Council's decision to deny the construction permit was not grounded in considerations concerning "construction aspects or flaws of the physical facility"[118] but was mainly motivated by the opposition of the local population against the landfill. In the Tribunal's view, the decision was therefore not supported by evidence pertaining to legitimate criteria under the municipal construction law. The requirement to supply sufficient evidence also results in a duty to conduct fact-finding and to verify evidence before a final decision is taken. Furthermore, the requirement to give reasons aims at facilitating the legal review of an administrative decision.[119]

116 The Tribunal particularly pointed out that "the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear", *Metalclad v. Mexico* (supra note 52), par. 91.

117 See *Tecmed v. Mexico* (supra note 27), par. 161 *et seq.* More specifically on the elements of a fair hearing required under fair and equitable treatment *Weiler*, NAFTA Article 1105 and the Principles of International Economic Law, 42 Colum. J. Transnat'l L. 35, 79 *et seq.* (2003).

118 *Metalclad v. Mexico* (supra note 52), par. 93.

119 See *Tecmed v. Mexico* (supra note 27), par. 123.

Overall, fair and equitable treatment therefore requires that domestic administrative proceedings conform to standards that are derived from a process-oriented understanding of the rule of law.[120]

b) Exercise of Administrative Discretion

Fair and equitable treatment can also restrict or channel the exercise of the administration's discretionary power. The standard requires administrative agencies to sufficiently take into account the effect of their decisions on foreign investors. In addition, the element of consistency and the concept of legitimate expectations play an important role regarding the exercise of administrative discretion.

The case in *Middle East Cement Shipping and Handling Co S.A. v. Egypt*[121] involved the seizure and auctioning of the Claimant's vessel in order to recover debts the investor had incurred in relation to a state entity. Interestingly, the issue focused on the question whether the procedural implementation of the auction was valid, in particular whether sufficient notice of the seizure was given.[122] Arguably in conformity with Egyptian law, the notice was given by attaching a copy of a distraint report to the vessel, because the Claimant could not be found onboard the ship. The Tribunal, however, considered that the authority had wrongly exercised its discretion by using this *in absentia* notification instead of notifying the Claimant directly at his local address. Relying on the principle of fair and equitable treatment in interpreting the due process requirement in the expropriation provision of the Greek-Egyptian BIT, the Tribunal reasoned that

"a matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication […] irrespective of whether there was a legal duty or practice to do so by registered mail with return receipt".[123]

The exercise of administrative discretion can also be limited by the principle of consistency and the concept of legitimate expectations. Consistency requires that administrative agencies exercise their discretion according to uniform standards and do not deviate from standard procedures or the usual assessment of comparable circumstances. Consistency may not only influence administrative decision-making

120 See for parallel developments of transnational administrative law in the context of administrative proceedings in the EU/EC and similar developments under WTO law *della Cananea*, Beyond the State: the Europeanization and Globalization of Procedural Administrative Law, 9 Eur. Publ. L. 563 (2003).

121 *Middle East Cement Shipping and Handling Co S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award of April 12, 2002.

122 The issue turned around the question whether the seizure yielded the requirement of due process in the provision prohibiting direct and indirect expropriations without compensation in the Egyptian-Greek BIT and the principle of fair and equitable treatment.

123 *Middle East Cement Shipping v. Egypt* (supra note 121), par. 143.

with respect to the granting of licenses,[124] but can also restrict the intervention by administrative agencies in order to enforce domestic law. If, for example, the domestic administration has consistently tolerated a specific unlawful conduct, fair and equitable treatment may prevent them from intervening against a foreign investor who engaged in the same conduct. Similarly, legitimate expectations of the investor can reduce the administration's discretionary power. Acting contrary to representations made by government officials, for instance, constitutes a breach of fair and equitable treatment.[125]

2. Fair and Equitable Treatment and Domestic Judicial Proceedings

The rule of law elements derived from fair and equitable treatment also influence the institutional structure of the host state's judiciary and the procedural law they apply. Fair and equitable treatment requires that host states provide a fair and efficient system of justice,[126] including effective judicial dispute settlement procedures for the review of administrative acts[127] and dispute settlement between private parties.[128] In *Mondev v. United States* the Tribunal, for example, entertained the possibility that "the conferral of a general immunity from suit for conduct of a public authority affecting a NAFTA investment could amount to a breach of Article 1105(1) of NAFTA".[129] In *Azinian v. Mexico* the Tribunal pointed out that "a denial of justice could be pleaded if the relevant courts refused to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way".[130] Accordingly, fair and equitable treatment grants a right to access to domestic courts for foreign investors.

Similarly, the procedural law applied by domestic courts has to conform to the rule of law requirements stemming from fair and equitable treatment. This requires

124 See *MTD v. Chile* (supra note 18), par. 107 *et seq.*

125 See *International Thunderbird Gaming v. Mexico* (supra note 76), par. 137 *et seq.*; *Metalclad v. Mexico* (supra note 52), par. 85 *et seq.*

126 *Loewen v. United States* (supra note 93), par. 153 with further references.

127 *Cf,* also *Waste Management v. Mexico* (supra note 25), par. 116: "the availability of local remedies to an investor faced with contractual braches is nonetheless relevant to the question whether a standard such as article 1105(1) have [sic] been complied with by the State."

128 *Loewen v. United States* (supra note 93), par. 129: "customary law is concerned with the denial of justice in litigation between private parties"; *ibid.*, par. 123: "it [is] the responsibility of the State under international law and, consequently, of the courts of a State, to provide a fair trial of a case to which a foreign investor is a party. It is the responsibility of the courts of a State to ensure that litigation is free from discrimination against a foreign litigant and that the foreign litigant should not become the victim of sectional or local prejudice."

129 See *Mondev v. United States* (supra note 10), par. 151 (concluding, however, that the immunity granted to a municipal authority in the case at hand was not a violation of fair and equitable treatment).

130 *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States*, ICSID Case No. ARB (AF)/97/2, Award of Nov. 1, 1999, par. 102.

courts to entertain suits in a timely fashion, to give a fair hearing to the foreign investor on all essential questions, not to base a decision on unexpected legal grounds and give reasons for the decisions reached.[131] In essence, concerning the judicial proceedings the obligations stemming from fair and equitable treatment will be similar to the obligations arising under human rights instruments, such as Art. 6 of the European Convention on Human Rights.[132]

3. Fair and Equitable Treatment and Domestic Legislation

Finally, fair and equitable treatment also affects the way national legislation deals with foreign investors.[133] Although domestic legislation is only rarely subject to the assessment of investment tribunals, mainly due to the fact that it often requires specific implementation by administrative or judicial decisions and does not affect foreign investors directly,[134] fair and equitable treatment can result in significant restrictions of the domestic legislator, mainly based on the rule of law element of legitimate expectations or protection of confidence.

So far the apparently only case that concerned the impact of fair and equitable treatment on the domestic legislator is the dispute in *CMS v. Argentina*. Although the Tribunal emphasized that it "does not have jurisdiction over measures of general economic policy […] and cannot pass judgment on whether they are right or wrong […] it has jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct

131 See *Azinian v. Mexico* (supra footnote 130), par. 102. To a lesser extent fair and equitable treatment may also require the outcome of a legal decision to conform to substantive rule of law standards or, as expressed by the Tribunal in *Aguas del Aconquija v. Argentina* (supra note 93), par. 80: "substantive justice".

132 *European Convention for the Protection of Human Rights and Fundamental Freedoms and its protocols*, 4 Nov. 1950, 213 U.N.T.S. 222. For this analogy see *Mondev v. United States* (supra note 10), par. 144. Compare also Art. 19(4) of the German Basic Law that provides for a guarantee to have judicial recourse against acts of public authority.

133 Under general international law it is established that the internal law of a state cannot be invoked as a justification for its failure to perform a treaty, see Art. 27 of the Vienna Convention on the Law of Treaties. As a consequence, the breach of an international obligation by the domestic legislator entails state responsibility since acts of the legislator can constitute internationally wrongful acts. Art. 4(1) of the ILC Draft Articles on State Responsibility. See for further authority *International Law Commission,* Commentary on the Draft Articles on State Responsibility, Art. 4 par. 4 (2001), available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

134 *Cf.* on the question of the self-executing nature of expropriatory legislation *Jahangir Mohtadi, et al. and The Government of the Islamic Republic of Iran*, Award No. 573-271-3 (2 Dec. 1996), 32 Iran-U.S. C.T.R. 124, 140 *et seq.*; *Reza Said Malek and The Government of the Islamic Republic of Iran*, Final Award No. 534-193-3 (11 Aug. 1992), 28 Iran-U.S. C.T.R. 246, 266 *et seq.*

bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[135]

On the merits, the Tribunal in *CMS v. Argentina* specified that transparency, consistency in the governmental decision making process, orderly process and predictability constituted the core elements of fair and equitable treatment also with respect to national legislation.[136] Measures that entirely converted the existing legal framework, such as the fundamental change in the U.S. dollar-based tariff calculation that the investor relied upon when making its initial investment decision, were found to breach fair and equitable treatment. Arguably, the key factor in this context was the permanent abrogation of the existing tariff system that completely waived the central promises made vis-à-vis the investor and breached his expectations.[137]

Yet, the protection of confidence should not be interpreted as an absolute guarantee. Rather, as the Tribunal in *Saluka v. Czech Republic* rightly pointed out, "[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged".[138] Although the stability of the legal framework is an essential factor for the investment decision of foreign investors, one cannot presume that host states denounced their right to legislate and change domestic legal rules by entering into international investment treaties. Concerning the concept of legitimate expectations, it therefore seems appropriate to draw a distinction between situations where a host state has incited specific confidence in the stability of certain regulations and situations where a foreign investor merely relied on the regulatory framework of the host state in a more general way.

In the first case, the concept of legitimate expectations will find its genuine application. Not only are expectations in this context directly attributable to a host state, but moreover did the host state know about the specific weight the foreign investor placed on the regulatory infrastructure in making its investment decision. Yet, absent specific commitments, legitimate expectations will not operate so as to prevent any changes in the regulatory framework. Based on the principle of proportionality, in particular emergency situations may justify even severe interferences.[139]

In the second case, where a foreign investor merely relies on the general legal framework without any specific commitments or intention on behalf of the host state to attract foreign investors, the concept of legitimate expectations may only have a more marginal scope of application. It will mostly come into play with respect to legislation with a retroactive affect.[140] Apart from that, it is difficult to imagine

135 *CMS v. Argentina* (supra note 48), Decision on Jurisdiction, par. 33.
136 *CMS v. Argentina* (supra note 13), par. 276 *et seq.* with further references.
137 See also *Costamagna* (supra note 81), 3 TDM (issue 2, April 2006), p. 6 *et seq.*
138 *Saluka v. Czech Republic* (supra note 19), par. 305.
139 Compare *Christie*, What Constitutes a Taking of Property Under International Law?, 38 Brit. Yb. Int'l L. 307, 331 (1962) (noting that in the context of expropriation the purpose of a host state's conduct may justify "even severe, although by no means complete, restrictions on the use of property").
140 See for example *Schulze-Fielitz* (supra note 37), Art. 20 par. 139 *et seq.*

cases of legislative regulatory change that violate fair and equitable treatment but do not at the same constitute measures with an expropriatory effect.

III. Methodological Implications of the Rule of Law Approach

Understanding fair and equitable treatment as an embodiment of the rule of law does not only clarify its normative content, it also suggests a specific methodology investment tribunals should follow in concretizing the standard and in solving conflicts between the sometimes competing interests of host states and foreign investors. Instead of primarily relying on prior arbitral decisions, an approach that is little helpful in particular when disputes concern novel circumstances, or positing the content of fair and equitable treatment in an abstract way without sufficient justification, tribunals should use a comparative method that draws on domestic and international law regarding the concept of the rule of law. These bodies of law can elucidate the meaning and specific implications of rule of law requirements.

1. Comparative Analysis of Domestic Legal Systems

The first approach relies on a comparative approach to rule of law standards contained in the major domestic legal systems that adhere to a liberal tradition. This approach essentially relies on the attempt to extract general principles of law in order to concretize fair and equitable treatment. This approach has also been proposed in order to concretize the concept of indirect expropriation under international law and its distinction from non-compensable regulation.[141] With respect to the concept of the rule of law, such an approach can be made equally fruitful for the application of fair and equitable treatment. Arbitral tribunals should therefore engage in a comparative analysis of the major domestic legal systems in order to grasp common features those legal systems establish for the exercise of public power.

Such a comparative analysis may influence the interpretation of fair and equitable treatment mainly in two respects. First, it may enable investment tribunals to positively deduce institutional and procedural requirements from the domestic rule of law standards for a context-specific interpretation of fair and equitable treatment. A comparative analysis of domestic legal systems and their understanding of the rule of law may, for example, be used to justify the standards administrative proceedings

141 *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht, p. 213 *et seq.* (1985); *Dolzer*, Indirect Expropriation of Alien Property, 1 ICSID Rev. - Foreign Inv. L. J. 41 (1986). Similarly *Salacuse/Sullivan*, Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain, 46 Harv. Int'l L. J. 67, 115 (2005).

affecting foreign investors have to live up to.[142] Secondly, a comparative analysis of the implications of the rule of law under domestic law may be used to justify the conduct of a state vis-à-vis a foreign investor under the fair and equitable treatment standard. If similar conduct, for instance the repudiation of an investor-state contract in an emergency situation, is generally accepted by domestic legal systems as being in conformity with their understanding of the (national) rule of law, investment tribunals can transpose such findings to the level of international investment treaties as an expression of a general principle of law.

2. Comparative Analysis of International Legal Regimes

The second methodological approach relies on a cross-regime comparison with other international law regimes that incorporate rule of law standards. A particularly promising field for such an approach is the comparative evaluation of the jurisprudence developed by international courts in the human rights context that address specific elements of the rule of law. The primary example in this context is the jurisprudence of the European Court of Human Rights (ECtHR) concerning Art. 6 of the European Convention on Human Rights (ECHR). This provision can be viewed as an expression of a more general standard of an institutional and procedural understanding of the rule of law.[143] The rich jurisprudence of the ECtHR could thus be used to further concretize fair and equitable treatment, for example with respect to the timely administration of justice or the right to a fair trial.[144] Similarly, comparative recourse could be had to the emerging principles of European administrative law[145] or the jurisprudence of the WTO Appellate Body in order to further develop the rule of law requirements with respect to the exercise of public power.[146] The comparative analysis of rule of law understandings under both domestic legal sys-

142 See also *della Cananea* (supra note 120), 9 Eur. Publ. L. 563, 575 (2003) (explaining that the WTO Appellate Body in the *Shrimps* Case has "subsumed from national legal orders some general or 'global' principles of administrative law" in order to impose procedural rule of law elements on the exercise of public power by WTO Member States).

143 This approach has occasionally already played a role in investment arbitration. See *Mondev v. United States* (supra note 10), where parallels were considered between Art. 7 ECHR (freedom from non-retrospective effect of penal legislation) and Art. 1105 NAFTA (par. 138) and between the assessment of granting immunity to a state agency under Art. 1105 NAFTA and Art. 6 ECHR (par. 141 et seq.). Another example of an investment tribunal that drew a parallel between the jurisprudence of the European Court of Human Rights and the Inter-American Court of Human Rights in the context of indirect expropriation is *Tecmed v. Mexico* (supra note 27), par. 166, 122.

144 For an account of the jurisprudence of the European Court of Human Rights concerning Art. 6 ECHR, see *van Dijk/van Hoof*, Theory and Practice of the European Convention on Human Rights, p. 391 *et seq.* (1998).

145 See, for example, *Schwarze*, Europäisches Verwaltungsrecht (2nd ed. 2005).

146 See *della Cananea* (supra note 120), 9 Eur. Publ. L. 563, 575 (2003).

tems and other international law regimes should be able to give examples for the effect of the rule of law and the scope of restrictions it imposes on states and thus help to inform the content of fair and equitable treatment in international investment law. Yet, it will, always be necessary to keep in mind the specific context of international investment treaties which aim at protecting and promoting foreign investment between the contracting state parties.

D. A Normative Justification of the Rule of Law Approach

Explaining the various context-specific implementations and sub-elements derived from fair and equitable treatment as an embodiment of the rule of law can also be normatively grounded in international investment treaties by linking this understanding to the intentions of the contracting state parties as expressed in the object and purpose of international investment treaties. This teleology can be instrumentalized in order to equate fair and equitable treatment with the concept of the rule of law as a guiding and restricting principle for the exercise of public power by host states. In particular, institutional economics suggest that the concept of the rule of law contributes to the promotion of foreign investment and, more generally, economic growth and development.

I. The Teleology of International Investment Treaties

As expressed in their preambles, international investment treaties aim not only at protecting but also at promoting foreign investment.[147] Investment flows will, however, depend on the decision of foreign investors to invest in a certain country. One critical factor for this investment decision is the political risk of the host country.[148] Consequently, international investment treaties intend to establish a legal regime

147 See *Dolzer/Stevens* (supra note 20), p. 11 *et seq.*, 20 *et seq.* (1995). See in general on the effects of bilateral investment treaties on actual flows of foreign investment *Neumayer/Spess*, Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?, 33 World Development 1567 (2005); *Salacuse/Sullivan* (supra note 141), 46 Harv. Int'l L. J. 67 (2005); *Tobin/Rose-Ackerman*, Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties, Yale Law School Center for Law, Economics and Public Policy Research Paper No. 293. (all suggesting, albeit to differing degrees the existence of an empirical link between the existence of BITs, the domestic policy framework and actual investment flows).

148 On the connection between international investment treaties and the reduction of political risk see *Rubins/Kinsella* (supra note 48), p. 1 *et seq.* (2005).

that reduces the political risk associated with foreign investment in order to increase investment flows between the contracting parties[149].

The mechanisms for the protection and promotion of foreign investment are, however, not an end in themselves. They are rather closely related to the goals of economic growth and development, in particular in developing countries. This was explicitly mentioned as an objective of the ICSID Convention that recognized "the need for international cooperation for economic development, and the role of private international investment therein".[150] The link between the inflow of foreign investment and economic development is further reinforced by the character of the World Bank as a development institution.[151] The implementation of an investor-state dispute settlement mechanism under the ICSID Convention aimed at reducing the political risk connected with investing in a developing country with weaker domestic institutions and a less stable legal and political infrastructure in the interest of growth and development.[152] Accordingly, from a macroeconomic perspective foreign investment is perceived as "a supplement to a necessarily limited volume of public development finance".[153]

II. Institutional Economics and the Role of the Rule of Law

Institutional economics help to explain the function of the rule of law with respect to both objectives of international investment treaties, i. e. the promotion of foreign investment and economic growth and development. Institutional economics analyze the relationship between institutions, markets and growth. Institutions, in this context, are "rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction."[154] Institutions are characterized by con-

149 See *Vandevelde*, The Economics of Bilateral Investment Treaties, 41 Harv. Int'l L. J. 469, 478 *et seq.* (2000) (concluding at 490 that the "principal contribution [of bilateral investment treaties] to increasing investment is to reduce risk for investors and thereby provide some inducements for those investments that the host state desires").

150 See the preamble of the ICSID Convention.

151 *Broches*, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 136 Recueil des Cours 331, 342 *et seq.* (1972-II); *Schöbener/Markert*, Das International Centre for Settlement of Investment Disputes (ICSID), 105 ZVglRWiss 65, 67 (2006).

152 See for an overview on the contentious question to what extent foreign investment actually contributes to economic growth *Cosbey*, International Investment Agreements and Sustainable Development: Achieving the Millenium Development Goals, p. 11 *et seq.* (2005), available at http://www.iisd.org/pdf/2005/investment_iias.pdf.

153 *Broches* (supra note 151), 136 Recueil des Cours 331, 343 (1972-II).

154 *North*, Institutions, Institutional Change, and Economic Performance, p. 3 (1990). See also *North*, Structure and Change in Economic History, p. 201 *et seq.* (1981) (defining institutions as "a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals").

straints with a certain permanence and durability which are imposed on actors.[155] They comprise legal rules that impose restrictions on the behavior of individuals as well as legal requirements that concern the exercise of public power. Institutions thus have a double thrust in avoiding private disorder, on the one hand, as well as public dictatorship on the other.[156] They are also essential for the functioning of markets as they "structure incentives in human exchange, whether political, social, or economic".[157] In this sense, the rule of law as a concept of restricting public power can be properly understood as an institution that constitutes one of the bases of market economies.

With respect to the immediate objective of international investment treaties, the concept of the rule of law is important in the context of attracting investment into foreign, particularly developing countries. This becomes clear from an empirical perspective. According to a survey by the World Bank, investors primarily make their decision to invest dependent upon the credibility of states to ensure a predictable and stable legal framework, or – in other words – to effectively implement the rule of law.[158] Conversely, government activity and domestic legal procedures that do not adhere to the concept of the rule of law constitute a critical deterrent for an investment decision in a specific country. Government according to the rule of law is therefore a prerequisite for risk-adverse investment decisions in a specific country. This fact should influence the interpretation of international investment treaties, in particular concerning the principle of fair and equitable treatment.

Yet, the rule of law does not only influence the foreign investor's microeconomic perspective. Instead, institutional economics also suggest a link between the rule of law and the broader objective of international investment treaties, i. e. economic growth and development, because "[e]conomic institutions matter for economic growth because they shape the incentives of key economic actors in society, in particular, they influence investments in physical and human capital and technology, and the organization of production."[159]

The importance of the rule of law in the decision making process of economic actors has been highlighted in economic literature since its earliest days. *Max Weber* was among the first scholars to argue for the interdependence of the emergence of modern forms of growth-creating market-economies in Western civilizations and a

155 See *Glaeser/La Porta/Shleifer*, Do Institutions Cause Growth?, 9 J. Econ. Growth 271, 275 (2004).

156 See for this double thrust in evaluating the rule of law as an economic institution *Djankov/Glaeser/La Porta/Lopez-de-Silanes/Shleifer*, The New Comparative Economics, 31 J. Comp. Econ. 595 (2003).

157 *North* (supra note 154), p. 3 (1990).

158 *World Bank*, *World Development Report – The State in a Changing World* 5, p. 34 *et seq.* (1997).

159 *Acemoglu/Johnson/Robinson*, Institutions as the Fundamental Cause of Economic Growth, Working Paper 10481, NBER Working Paper Series, p. 2, available at http://www.nber.org/papers/w10481.

modern legal system based on rational and predictable rules.[160] For him, the core explanation for economic growth in Europe was the rationality of the legal institutions, including the existence and enforcement of contracts and property rights, which had emerged in the socio-legal discourse in the 18th and 19th century and subsequently paved the way for the development of modern market economies.[161] *Weber* thus showed that modern law "helps structure the free market system".[162]

Although *Weber* primarily focused on the function of legal institutions to create horizontal order between private individuals by enabling them to use private law institutions for purposes of private ordering, institutions are also critical in the relationship between the state and society. In this context, the rule of law is the primary and, at the same time, most general expression for the predictable exercise of public power vis-à-vis the individual. This aspect complements the function of the rule of law as an institution that aims at not only avoiding private disorder but also public dictatorship.[163] It is also the aspect that grasps the public law understanding of the concept and its function of limiting the exercise of public power.

This aspect has been described as an important factor for the functioning of market economies and economic growth. Already *Adam Smith* noted that

"[c]ommerce and manufacturers can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufacturers, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government."[164]

Similarly, *F. A. Hayek* underscored the importance of the rule of law's restraining function with respect to public authority for modern market economies and economic growth. For him, "[n]othing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law."[165] In his reasoning,

160 *Weber*, Wirtschaft und Gesellschaft – Grundriss der verstehenden Soziologie (4th ed. *J. Winckelmann*, 1956).

161 For a short and informative summary of *Weber's* account of the relationship between law and economic growth see *Trubek*, Toward a Social Theory of Law: An Essay in the Study of Law and Development, 82 Yale L. J. 1, 11 *et seq.* (1972).

162 *Trubek* (supra note 161), 82 Yale L. J. 1, 15 (1972).

163 See *Djankov/Glaeser/La Porta/Lopez-de-Silanes/Shleifer* (supra note 156), 31 J. Comp. Econ. 595 (2003).

164 *Adam Smith*, cited in: *Rodrik/Subramanian/Trebbi*, Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development, 9 J. Econ. Growth 131 (2004). See also *North/Weingast*, Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England, 49 J. Econ. Hist. 803 (1989); *De Long/Shleifer*, Princes and Merchants: European City Growth Before the Industrial Revolution, 36 J. Law Econ. 671 (1993).

165 *Hayek*, The Road To Serfdom, p. 72 (1944).

market economies are based on the initiatives and decision-making of individuals who, in order to be able to plan their economic efforts, require governmental actions to be restricted according to rules "made in advance, in the shape of formal rules which do not aim at the wants and needs of particular people [, but] are intended to be merely instrumental in the pursuit of people's various individual ends."[166]

While the function of legal institutions was initially mainly of interest in explaining the economic development of industrialized nations and was debated in the ideological conflict between liberalism and socialism, lawyers and social scientists took interest in institutional economics after decolonization gained momentum after World War II in order to explain and remedy the economic weaknesses of many developing countries. In this context, the "law and development" movement focussed on the function of law in the Third World and its possible impact on sustainable economic growth.[167] In its core conception, the movement viewed "modern law […] as a functional prerequisite of an industrial economy", because it promoted the development of markets or, in a more state-centered view, enabled the state to use law as a tool to guide economic activity.[168] Notably, the concept of the rule of law figured prominently in the movement's theoretic framework.[169]

More recently, the linkage between institutions, growth and development is analyzed by new institutional economics. Scholars in this field particularly emphasize the significance of a well-functioning legal system that embodies the rule of law for economic growth and development. *Posner*, for instance, points to the "empirical evidence showing that the rule of law does contribute to a nation's wealth and its

166 *Hayek* (supra note 165), p. 73.

167 See for an overview of the law and development movement with further references see *Trubek* (supra note 161), 82 Yale L. J. 1 (1972).

168 *Trubek* (supra note 161), 82 Yale L. J. 1, 6 *et seq.* (1972).

169 See *Trubek/Galanter*, Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States, 1974 Wisc. L. Rev. 1062, 1071 (1974); see also *Trubek* (supra note 161), 82 Yale L. J. 1, 6 *et seq.* (1972) with further references. Although the scholarly endeavors of the law and development movement ended quickly in the United States because the perspective it assumed was criticized as centered on Western thought and little receptive to the needs and traditions of third world countries, its legacy continued in other countries and was also influential with respect to the development efforts of international organisations within the United Nations system. For an overview of the history of the law and development movement see *Tamanaha*, The Lessons of Law-and-Development Studies, 89 A.J.I.L. 470, 472 *et seq.* (1995).

rate of economic growth."[170] This evidence is also buttressed by various theoretic economic analyses.[171]

The findings of new institutional economics have also been at the core of the development strategy of the World Bank. The linkage between the rule of law and economic development has, in particular, materialized in the Bank's legal reform program.[172] It has also been reiterated in the World Bank's good governance agenda, which comprises, as one of the core concepts that help to establish good government in developing countries, the rule of law. In its 1992 report on *Governance and Development* the Bank stated, although not in respect of foreign investment, that

"[the] connection of the rule of law with efficient use of resources and productive investment, which must be understood and dealt with in highly specific and differentiated cultural and political settings, is the aspect most important to economic development, and hence to World Bank assistance."[173]

While the economic literature consistently points to parallels and interdependencies between economic development and the emergence of stable and reliable institutions, the nature of the relationship between institutions and economic growth is debated, in particular whether, and if so to what extent, a causal relationship be-

170 *Posner*, Creating a Legal Framework for Economic Development, 13 The World Bank Research Observer 1, 3 (1998). For empirical analyses see *De Soto*, The Other Path (1989); *De Long/Shleifer* (supra note 164), 36 J. Law Econ. 671 (1993); *Besley*, Property Rights and Investment Incentives: Theory and Evidence from Ghana, 103 J. Pol. Econ. 903 (1995); *Easterly/Levine*, Africa's Growth Tragedy: Policies and Ethnic Divisions, 112 Q. J. Econ. 1203 (1997); *Easterly/Levine*, Tropics, Germs, and Crops: How Endowments Influence Economic Development, 50 J. Mon. Econ. 3 (2003); *Knack/Keefer*, Institutions and Economic Performance: Cross Country Tests Using Alternative Institutional Measures, 7 Econ. & Pol. 207 (1995); *Acemoglu/Johnson/Robinson*, The Colonial Origins of Comparative Development: An Empirical Investigation, 91 Am. Econ. Rev. 1369 (2001); *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004).

171 For analyses in institutional economics see *Hayek*, The Constitution of Liberty (1960); *Olson*, The Logic of Collective Action (1965); *Olson*, Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships (2000); *Demsetz*, Towards a Theory of Property Rights, 57 Am. Econ. Rev. 347 (1967); *North*, Structure and Change in Economic History, p. 201 *et seq.* (1981); *North* (supra note 154), p. 3 (1990); *Posner*, Equality, Wealth, and Political Stability, 13 J. L. Econ. & Org. 344 (1997), *Barro*, Economic Growth in a Cross Section of Countries, 106 Quart. J Econ. 407 (1991), *Scully*, The Institutional Framework and Economic Development, 96 J. Pol. Econ. 652 (1988).

172 See for an analysis of the economic underpinnings and the development strategy of the World Bank's law reform program from a critical perspective *Tshuma*, The Political Economy of the World Bank's Legal Framework for Economic Development, 8 Soc. & L. Stud. 75 (1999).

173 *World Bank*, *Governance and Development*, p. 28 (1992). The concept of the rule of law that the World Bank endorsed is a primarily procedural understanding that comprises five elements that are considered to be conducive to good governance and hence economic development. *Ibid.*, p. 30 (1992): "(a) there is a set of rules known in advance, (b) the rules are actually in force, (c) there are mechanisms ensuring application of the rules, (d) conflicts are resolved through binding decisions of an independent judicial body, and (e) there are procedures for amending the rules when they no longer serve their purpose".

tween institutions and growth exists.[174] From this perspective it is unclear whether the development of legal institutions, including the rule of law, will result in economic growth or whether, in turn, legal institutions are a result of prior economic development and the pressure exercised by the respective interests of economic actors. Yet, even if institutions do not trump all other factors in the quest for economic growth,[175] they nevertheless constitute one important factor for growth and development. In addition, the debate about a causal relationship between institutions and growth seems to be mitigated in the context of foreign investment by the fact that a certain institutional infrastructure that reduces the investment risk is necessary to attract foreign investment. Therefore the critique concerning the causality between institutions and growth seems to be less convincing than in a setting where growth is to be based solely on internal and self-induced economic activity.

Although the rule of law is surely not the only variable that influences economic growth,[176] institutional economics show the importance of the concept for growth and development. Consequently, it seems appropriate to draw a connection between the economic analysis of institutional economics, in particular its emphasis on the impact of the rule of law both on the microeconomics of foreign investors and its macroeconomic implications, and the normative framework of international investment treaties.[177] This gives a normative foundation for interpreting fair and equitable treatment as an embodiment of the concept of the rule of law since states presumably intended to establish institutions that effectively contribute to the object and purpose of international investment treaties and thus to growth and development.

174 See, for example, *Glaeser/La Porta/Shleifer* (supra note 155), 9 J. Econ. Growth 271 (2004) (denying a causal relationship and emphasizing the importance of human capital). *Easterly/Levine* (supra note 170), 50 J. Mon. Econ. 3 (2003) (emphasizing the importance of geography as the decisive factor for economic growth in developing countries). Arguing instead for a positive causal relationship see, for example, *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004), *Acemoglu/Johnson/Robinson*, (supra note 170), 91 Am. Econ. Rev. 1369, 1395 (2001).

175 In this sense *Rodrik/Subramanian/Trebbi* (supra note 164), 9 J. Econ. Growth 131 (2004).

176 See *North*, Economic Performance Through Time, 84 Am. Econ. Rev. 359, 366 (1994): "[…] transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance."

177 See also *Schneiderman*, Investment Rules and the Rule of Law, 8 Constellations 521 *et seq.* (2001) (arguing that "[t]he investment rules regime is intended to protect established investments abroad far into the future by locking countries into predictable regulatory frameworks. The objective is to bind states to a version of economic liberalism, to impose the discipline of the 'rule of law' on state regulation of the market; domestic rules are thereby rendered predictable and certain.").

E. Conclusion

Fair and equitable treatment has become one of the standard guarantees of protection in international investment treaties and is regularly applied by investment tribunals as a basis for ordering host states to pay damages to foreign investors. The scope given to it in recent investment arbitration is increasingly wide, covering restrictions of domestic courts, domestic administrative bodies and even the national legislator. This transforms fair and equitable treatment into a quasi-constitutional concept that overarches the activity of states vis-à-vis foreign investors. At the same time, arbitral tribunals and scholars in the field of investment protection and public international law frequently note the amorphous structure, the lack of a definition and, in more general terms, the lack of a conceptual understanding of the normative content of this wide-spread treaty standard.

The vagueness of the fair and equitable treatment standard constitutes structural problems for the principle's interpretation and construction by arbitral tribunals. While the arbitral jurisprudence continuously develops a more precise meaning of fair and equitable treatment, it nevertheless meanders around without any clear conceptual vision of the principle's function. The reasoning in arbitral awards is therefore often weak or even unconvincing in its legal analysis. It regularly restricts itself to invoking equally weakly reasoned precedent or refers in an inconclusive manner to the object and purpose of BITs without any deeper justification of how the specific construction contributes to the treaties' objective. Ultimately, these shortcomings endanger the suitability of fair and equitable treatment as a concept against which the conduct of host states can be measured. The main concern in this context is that the jurisprudence does not produce predictable results that are accepted by states but endorse an approach that allows for a broad *ex post facto* control of host state conduct. Predictability in its application is, however, essential for host states and foreign investors alike who need to know beforehand what kind of measures entail the international responsibility of the state and, accordingly, against which kind of political risk fair and equitable treatment protects.

In order to grasp the normative content of fair and equitable treatment, this article submitted that the standard can be understood as an embodiment of the rule of law. The survey of investment decision shows that the concept underlying fair and equitable treatment is functionally equivalent to the understanding of the requirements deduced from the rule of law under domestic legal systems and other international law regimes. Investment tribunals have thus interpreted fair and equitable treatment so as to encompass sub-elements the rule of law is associated with in various domestic legal systems. In this respect, the jurisprudence of arbitral tribunals concerning fair and equitable treatment can be analyzed as including (1) the requirement of stability and predictability of the legal framework and consistency in the host state's decision-making, (2) the principle of legality, (3) the protection of investor confidence or legitimate expectations, (4) procedural due process and denial of justice, (5) protection against discrimination and arbitrariness, (6) the requirement of transparency and (7) the concept of reasonableness and proportionality.

In its core, the rule of law understanding underlying the jurisprudence of investment tribunals can be described as primarily procedural and institutional in nature. Accordingly, the control exercised by investment tribunals over the conduct of host states is mainly concerned with the institutional structure and the procedural implementation of law and policy which affect foreign investors. Fair and equitable treatment, for example, requires the existence of a minimal separation of powers in host states, the possibility of recourse to courts for the adjudication of private rights and the review of acts of public authorities, legal security, protection of legitimate expectations and the observance of procedural rights in administrative and judicial proceedings.

At the same time, such a procedural and institutional understanding of the rule of law allows states sufficient leeway in implementing their own substantive policy choices and in reacting to newly emerging circumstances, including state emergencies. Fair and equitable treatment does, however, not only influence the way host states change their regulatory frameworks after an investment was made,[178] but in a more comprehensive way requires them to adapt their domestic legal orders to standards that are internationally accepted as conforming to the concept of the rule of law. While, the paper only aimed at outlining the general features of a rule of law understanding of fair and equitable treatment and tried to explain the concept and function of this widely used treaty standard, the exact contours of the various subelement still require further elaboration and context-specific analyses.

Arguably, such an understanding of fair and equitable treatment can be supported by an economic analysis of international investment treaties. This is particularly true considering the object and purpose of investment treaties that aim at protecting and promoting foreign investment flows and ultimately economic growth and development. This purposive link between the protection standards contained in the treaties and the promotion of investment justifies drawing a parallel to the economic literature that expands on the relationship between the rule of law and economic growth. The positive economic impacts that are linked to the rule of law and the incentive structure necessary for foreign investors to invest in a specific country suggest such an understanding of fair and equitable treatment as appropriate in the context of investment treaties. This can be buttressed by the assumption that states intended to have the most efficient structures implemented in order to promote investment flows. Finally, the paper suggests that tribunals should draw – in a comparative approach – on the jurisprudence of domestic and international courts on rule of law standards in order to further concretize fair and equitable treatment. This would help to convincingly justify and apply fair and equitable treatment in various context-specific fields of economic activity and state regulation. At the same time, the reference to rule of law concepts under domestic legal orders also illustrates that the rule of law is not an absolute guarantee but rather allows for a balance between the interests of host states and foreign investors. In this context, one should keep in

178 In this sense *Dolzer* (supra note 8), 39 Int'l Law. 87, 100 *et seq.* (2005).

mind the words of *Joseph Raz* who concluded his seminal article on the *The Rule of Law and its Virtue* by recalling:

"After all the rule of law is meant to enable the law to promote social good, and should not be lightly used to show that it should not do so. Sacrificing too many social goals on the altar of the rule of law may make the law barren and empty."[179]

179 *Raz* (supra note 39), 93 L. Quart. Rev. 195, 211 (1977).

"Expropriation" and "Fair and Equitable Treatment" Standards in Recent ICSID Jurisprudence

Comment by *Jo Delaney*[*]

Thank you to Professor *Hofmann* and the organisers for their kind invitation and giving me, a younger practitioner, an opportunity to present.

Mr *Schill's* comprehensive analysis of the standards of expropriation and fair and equitable treatment raises many thought provoking questions.

I want to focus on the interrelationship between the two standards in the 10 minutes I have. As Mr *Schill* has referred to in his analysis, the trend in recent investment cases, ICSID and non-ICSID, raises questions about the role of the legitimate expectations of the investor and how such expectations connect these two standards. First, I want to briefly address the increasing emphasis on legitimate expectations as an essential element of fair and equitable treatment. Then, I will look at the role of the investor's expectations in determining whether there has been an expropriation, particularly a "regulatory taking", which is itself a growing concept.

A. Legitimate Expectations - Fair and Equitable Treatment

The focus on the legitimate expectations of the investor has widened the standard of "fair and equitable" treatment beyond the minimum standard for aliens in customary international law. Recent cases have emphasised that fair and equitable treatment not only requires the State not to act in an unreasonable or arbitrary manner or to ensure good faith or due process, but it also now requires that the State consider and act consistently with the legitimate expectations of the investor.

The respect for the investor's "legitimate expectations" was explained in detail in paragraph 154 of the Tribunal's Award in the *Tecmed* case. I won't read out the paragraph as it is very long but the Tribunal referred to the need for the State to act consistently, "free from ambiguity and totally transparently", not only in relation to regulations but the goals of regulations so the investor can plan its investment and comply with the necessary regulations. The Tribunal emphasised that consistency requires the State not to arbitrarily revoke any pre-existing decisions or permits which the investor has relied upon and to act in conformity with any regulations.

This approach has been adopted in subsequent cases which have also been analyzed by Mr *Schill*:

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- *MTD v Chile (ICSID)* where the Tribunal found that it was unfair that the State (acting through one body) approved an investment and entered into a foreign investment contract when the investment was against the policy of the State itself in that the State would not change a zoning permit in order to grant the necessary permits for the investment.
- *Occidental Petroleum v Ecuador (UNCITRAL)* - where the Tribunal found that the State had acted without clarity and inconsistently in relation to the tax change and its practice and regulations in relation to VAT refunds. The investor had entered into participation contracts for the exploration and production of oil and had been able to claim VAT refunds but in 2001 there was a change in tax policy by the SRI (tax authority) and subsequent VAT refunds were denied.
- *CMS v Argentina (ICSID)* - where the Tribunal found that the State had not provided a stable legal and business environment as required as an essential element of fair and equitable treatment, these guarantees being crucial for the investor's investment decision]

Most recently, it was considered by the NAFTA Tribunal in *Thunderbird Gaming Corporation v Mexico* (UNCITRAL), the ad hoc Tribunal in *Eureko v Poland* and the UNCITRAL Tribunal in *Saluka Investments BV v Czech Republic* (otherwise referred to as *Nomura* case).

While *Saluka* was not an ICSID case but under the UNCITRAL Rules, the Tribunal's comments are still instructive to future ICSID Tribunals. The Tribunal in that case emphasised that "legitimate expectations" was the "dominant element" of the fair and equitable standard. The investor's expectations included the State's observation of "good faith, due process and non-discrimination" (para 303). The Tribunal stressed that such expectations must be legitimate and reasonable "in light of the circumstances" (para 304).

The Tribunal held that the Czech Republic undertook an obligation not to frustrate the legitimate and reasonable expectations of the investor (para 302) and found that the Czech Republic had breached the investor's legitimate expectations such that it had treated the investor unfairly and inequitably. It is how the Tribunal found this breach, while also holding that its conduct did not amount to expropriation because of the State's right to regulate that I want to focus on but first I will address the role of legitimate expectations in expropriation.

Similarly in *Thunderbird Gaming Corporation v Mexico*, the NAFTA Tribunal held that if the State's conduct creates legitimate expectations and the investor acts in reliance on that conduct, the State must honour those expectations if a failure to do so would cause damage to the investor (para 147).

Professor *Thomas Walde* expanded upon this concept in his Separate Opinion, emphasising that the expectation must be "legitimate" through some official conduct and that the investor must have relied upon that conduct to its detriment (para 1, 21, 119).There must be reasonable detrimental reliance if the investor is to be entitled to compensation.

B. Legitimate Expectations - Expropriation

The investor's legitimate expectation is often the starting point for a tribunal's analysis of whether there has been an expropriation of the investment.

For example, in *Metalclad*, the Tribunal looked to whether the investor had been deprived "in whole or in significant part, of the use or reasonably-to-be expected economic benefit of the property" (para 103).

In *Tecmed*, the Tribunal looked at the investor's expectations of its return on the investment, particularly since it was a long term investment that required time to establish the business and recover the investment and obtain an expected return. In determining whether there had been an expropriation of the investment, the Tribunal analysed (1) the reasonable expectations of the investor for a return; (2) whether the State had failed to protect the investor's rights when the State was confronted with social opposition; and (3) whether the measures taken were proportionate to the investor's expectations or excessive in light of the social protests.

In both of these cases, the Tribunals found that the State had deprived the investor of its legitimate expectations to a return or economic benefit and thus had expropriated the investment. They also found a breach of fair and equitable treatment.

However, in some cases, even though the Tribunal found that the State acted inconsistently with the investor's legitimate expectations and found a breach of the fair and equitable treatment standard, it did not found that the State's conduct amounted to an expropriation of the investment. There is not necessarily any inconsistency between these two findings but there may be where the alleged expropriation is found to be a legitimate regulation.

For example, in *CMS*, the Tribunal found that the State failed to provide a stable legal and business environment due to the uncertainty of the period from 2000 to 2002 and the final determinations under the Emergency Law, thereby in breach of the fair and equitable treatment standard. However, it did not find an expropriation as (1) *CMS* retained full ownership and remained in control of the investment; and (2) the Government had not managed the day-to-day operations of the company. In this case, the Tribunal focused on the investor's continuing ownership, management and control rather than whether Argentina's regulatory measures were legitimate.

But what if the investor does lose its investment, as in the *Saluka* case? Can a regulation that is said to be legitimate also be consistent with the legitimate expectations of the investor? What if the carrying out of that regulation by the State is inconsistent with investor's expectations? How is the State's legitimate regulation to be balanced against the investor's legitimate expectations?

The *Saluka* case raises questions about the interrelationship between an investor's legitimate expectations in the context of fair and equitable treatment on the one hand, and expropriation, on the other. The alleged expropriation in this case was a "regulatory taking". The Tribunal found that the State's regulatory actions were justified: i.e. that the Czech National Bank was justified in imposing the forced administration on the bank and appointing an administrator, particularly since the

decision had been confirmed by the CNB Appellate Board and upheld by the Prague City Court twice.

Yet the Tribunal also found that the State had acted unfairly and inequitably, contrary to *Saluka/Nomura's* legitimate expectations:

- (1) The State had failed to provide financial assistance to IPB for the bad debt problem when it had provided that assistance to three of the Big Four banks. The Tribunal recognised that this failure was discriminatory and created an environment which made it impossible for the IPB to survive. *Saluka* was justified in expecting to be treated in an even-handed and reasonable manner.
- (2) The State had also failed to take seriously *Saluka's* proposals to solve the problem and deal with it in an objective, transparent, unbiased and even-handed way. The State had failed to address *Saluka's* proposal and had unreasonably refused to communicate with IPB and *Saluka/Nomura* in an adequate manner.

What is difficult to digest with this case is that it was the CR's conduct in relation to its failure to provide financial assistance and its failure to consider Nomura's proposals, these both being contrary to *Saluka/Nomura's* legitimate expectations, which led to the factual circumstances that resulted in the Czech National Bank having to take the decision to place IPB in forced administration leading to the alleged expropriation. If *Saluka/Nomura's* legitimate expectations had been fulfilled, then the forced administration may not have been necessary. Yet the Tribunal found that the forced administration was a justifiable regulatory step that did not amount to expropriation.

Other tribunals analysing alleged regulatory takings have taken a different approach, e. g. in the *Feldman* case, where the Tribunal acknowledged that not all regulatory measures amount to an expropriation.

In *Tecmed*, which Mr *Schill* also referred to, the Tribunal emphasised that measures, whether or not they were regulatory, amounted to an indirect expropriation if they were "irreversible and permanent" and the "economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed" (para 116). The Tribunal emphasised that it was the effect of the measures, not the intent that was important. The Tribunal also looked to whether the measures were proportionate to the public interest they intended to protect and found that in that case they were disproportionate.

Beyond looking at the proportionality of the measures, the Tribunal did not offer any assistance in determining when a legitimate regulatory measure crosses the line and amounts to a regulatory taking or expropriation. However, would the proportionality test have assisted the Tribunal in *Saluka*?

The UNICTRAL Tribunal in *Saluka* acknowledged that the threshold for regulatory takings has not yet been defined, but did not offer any suggestions as to what would be appropriate criteria in determining that threshold, other than referring to the *Harvard Draft Convention* of the 1960s which recognised that *bona-fide* non-discriminatory regulation was not expropriation and set out 4 exceptions, which I

will not go into due to time. In the context of analysing the fair and equitable treatment standard, the Tribunal focused on the expectations of the investor and the need to balance those expectations with the State's legitimate regulatory interests (para 305-6). But it did not do so in the context of the expropriation claim. If it did, perhaps it would have reached a different conclusion. Or if the Tribunal had analysed whether the decision of forced administration was proportionate to *Saluka's* legitimate expectations, it may have reached a different conclusion.

C. Conclusion

Accordingly, it appears that we must be content with the vague indications given by investment tribunals to date on the role of legitimate expectations in the analysis of these two standards:

- Legitimate expectations of the investor is an essential element of the fair and equitable treatment standard;
- It may be the starting point for an analysis of an expropriation claim;
- The investor's legitimate expectations may need to be balanced against the legitimate regulatory interests of the State if regulatory measures have allegedly led to an expropriation;
- However, how are these expectations and regulatory interests to be balanced?
- Is it sufficient to consider whether the regulatory measures are proportionate to the investor's expectations?

Hopefully, we will all have an opportunity to encourage future Tribunals to provide some guidance to these questions, preferably within the next 4-5 years rather than the next 40 years.

"Fair and Equitable Treatment" – Determining Compensation

Comment by *Kaj Hobér*[*]

A. Introduction

Fair and equitable treatment is one of the standards of treatment of foreigners under international law. One of the early sources for a discussion of the treatment of foreigners is the *Neer Case*.[1] The concept of fair and equitable treatment did not exist at that time, but the case does address in general terms treatment of foreigners by a host State.

In the post Second World War attempts to regulate the international economy – resulting in the establishment of the World Bank and the International Monetary Fund – the negotiating states also tried to create a world trade organization, later referred to as the International Trade Organization. In the 1948 Havana Charter for the International Trade Organisation it was stated in Article 11(2)[2] that the International Trade Organisation could make recommendations and promote bilateral or multilateral agreements on measures designed *"to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another"*. In the same year the Ninth International Conference of American States adopted the Economic Agreement of Bogotá under which foreign capital were to receive "equitable treatment" [3] (Article 22). However, neither the Havana Charter, nor the Agreement of Bogotá came into force. In the 1950's refer-

* *Kaj Hobér*, Partner Mannheimer Swartling, Stockholm; Professor of East European Commercial Law, Uppsala University.

1 *Neer v. Mexico*, Opinion, United States – Mexico General Claims Commission, 15 October 1926 21 American Journal of International Law (1927) 555.

2 Article 11(2) of the Havana Charter reads as follows: "The Organization may, in such collaboration with other inter-governmental organizations as may be appropriate:
(a) make recommendations for and promote bilateral or multilateral agreements on measures designed.
(i) to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another;
(ii) to avoid international double taxation in order to stimulate foreign private investments;
(iii) to enlarge to the greatest possible extent the benefits to Members from the fulfilment of the obligations under this Article;
(b) make recommendations and promote agreements designed to facilitate an equitable distribution of skills, arts, technology, materials and equipment, with due regard to the needs of all Members;
(c) formulate and promote the adoption of a general and treatment of foreign investment."

3 "Los capitales extranjeros recibirán tratamiento equitativo".

ences to fair and equitable treatment started to appear in the US Treaties on Friendship, Commerce and Navigation.[4]

As noted by *Stephan Schill* in his article "*'Fair and Equitable Treatment' as an Embodiment of the Rule of Law*", arbitral tribunals have struggled, and continue to struggle, with a definition of the rather vague concept of fair and equitable treatment, and have, so far, been unable to develop a uniform methodology for determining when a violation of fair and equitable treatment has occurred.[5]

These difficulties do not come as a surprise. The standard of fair and equitable treatment is relatively imprecise and is very much dependent on the specific circumstances of the individual case. The principle can thus not be applied in the abstract. The standard of fair and equitable treatment is a broad principle of international law which must, like other such principles, be specified, refined and supplemented by decisions of international tribunals. In fact this is the only realistic approach, since it would be virtually impossible to anticipate and specify in detail host State conduct that should be covered by this principle.

The aforementioned lack of precision notwithstanding, *Stephan Schill* has identified seven normative elements forming part of the reasoning of arbitral tribunals when analysing the principle of fair and equitable treatment, *viz.,* (i) the requirement of stability, predictability and consistency of the legal framework, (ii) the principle of legality, (iii) the protection of investor confidence or legitimate expectations, (iv) procedural due process and denial of justice, (v) substantive due process or protection against discrimination and arbitrariness, (vi) the requirement of transparency and (vii) the requirement of reasonableness and proportionality.[6]

The purpose of this contribution is to address another aspect of fair and equitable treatment, *viz.*, to analyze arbitral practice with the aim of identifying principles, if any, for the *determination of the compensation* for violation, once established, of the fair and equitable treatment standard.

B. Compensation for Violation of the Fair and Equitable Treatment Standard

I. Introduction

Almost all recent Bilateral Investment Protection Treaties (BIT:s) require that investors covered by the treaty in question receive fair and equitable treatment. This principle is also enshrined in the North American Free Trade Agreement (NAFTA)[7] as

4 See further Fair and Equitable Treatment Standard in International Investment Law, OECD Working Papers on International Investment No. 2004/3, p. 3-4.

5 See *Schill*, p. 35-36.

6 *Schill*, p. 41-42.

7 Article 1105(1) of NAFTA reads as follows: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security".

well as in the Energy Charter Treaty (ECT)[8]. In none of these treaties, however, is there any provision, nor language, addressing the issue of compensation in case of violation of the fair and equitable treatment standard. The situation is of course different with respect to expropriation. Most investment protection treaties, bilateral as well as multilateral, have provisions addressing compensation in case of expropriation.

II. The Legal Basis for Compensation

The determination of compensation for violations of the fair and equitable treatment standard is, however, not made in a legal vacuum. The legal basis is found in customary international law. Article 31 of the International Law Commission's (ILC) Articles on State Responsibility reads as follows:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of State.

The principles expressed in this Article are generally held to represent generally accepted customary international law. These principles were formulated already by the Permanent Court of International Justice in the *Chorzow Factory* case.

The Court said:

> "It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form. Reparation therefore is the indispensable complement to a failure to apply a convention and there is no necessity for this to be stated in the convention itself. Differences relating to reparations, which may be due by reason of failure to apply a convention, are consequently differences relating to its application".[9]

8 Article 10(1) of the ECT reads as follows "Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment […]".

9 *Factory at Chorzów*, 1927, P.C.I.J., Series A, No. 9, p. 2.

Under the *Chorzów Factory* case, the State violating international law is liable to provide full compensation, *i.e.* to re-establish the situation, which would have existed had that violation not occurred:

> "The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, so far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."[10]

Article 34 of the ILC Articles then goes on to describe the different forms of reparation. They include restitution, compensation and satisfaction.

Even though the primary form of reparation under the ILC Articles is restitution, from an investment dispute point of view, the practically relevant form is compensation, which is regulated in Article 36. It reads:

> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profit insofar as it is established.

In the context of compensation for violations of the fair and equitable standard, suffice it to make two comments at this stage.

First, Article 31 refers to "full reparation". This means, in the words of the Chorzow Factory case "to wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed".[11] This principle has been extensively discussed with respect to calculation of compensation for expropriation. Difficult as it may be to apply this principle to expropriation, it is at least arguable that this is easier than to apply the principle to compensation for violations of the fair and equitable standard. The typical situation

10 *Factory at Chorzów*, 1928, P.C.I.J., Series A, No. 17, p. 47.
11 See note 10, *supra*

with respect to an expropriation is that it puts an end to the investment in question. Violations of the fair and equitable standard do not necessarily lead to this result, but the investment, e.g. a business activity, may well continue. The difficulty then is to determine what "full reparation" means in this context.
The foregoing leads to the *second* observation. It is clear from the language used in Articles 31, 34 and 36 that there must be a causal link between the injury and the internationally wrongful act. The provisions all refer to the "*injury caused by the internationally wrongful act*". In the context of fair and equitable treatment, it is not difficult to envisage situations where it must be very complicated to determine the extent to which an injury has been caused by a violation of this standard and not by any other event.

C. Decisions by Arbitral Tribunals

I. Introduction

There are few recent decisions by arbitral tribunals in investment disputes, which deal with compensation for violations of the fair and equitable standard as a discrete and separate matter. This is perhaps not very surprising since many, if not most, investment disputes primarily focus on expropriation. Questions of fair and equitable treatment then tend to play a secondary role, and are not given separate treatment. There are three recent ICSID cases which address the issue of compensation for violations of the fair and equitable treatment standard as a separate matter. The only two cases decided so far on the merits under the ECT also deal with these issues, as do at least three NAFTA cases. These cases will be discussed in the following.

II. ICSID cases

1. MTD v. Chile

In *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*[12]*, MTD* (Malaysia) had invested in Chile by participating in a joint venture which planned to buy land for the purpose of constructing a mixed use upscale community. The investment was made through a local company, *MTD* Chile, which in turn invested in and owned 51 percent of the joint venture company, El Principal, which was to own the land and develop the project. The investment was approved by the Foreign Investment Commission (FIC) and a foreign investment contract was signed. An addi-

12 ICSID Case No. ARB/01/7, Award of 25 May 2004.

tional capital contribution by *MTD* was subsequently approved by the FIC. Thereafter the project ran into difficulties resulting from the absence of a change of zoning legislation for the use of land. In the end the project was not approved by the authorities.

The applicable Malaysia-Chile BIT contained an MFN-clause, which in the view of the Tribunal made substantive protection standards of other Chilean BITs applicable as argued by the Claimants.

In the arbitration the Claimants alleged that the Respondent had breached:

(i) Articles 2(2) and 3(1) of the BIT and Article 4(1) of the Croatia BIT by treating their investment unfairly and inequitably;
(ii) Article 3(1) of the Denmark BIT by breaching the Respondent's obligations under the Foreign Investment Contracts;
(iii) Article 3(2) and (4) of the Croatia BIT by impairing through unreasonable and discriminatory measures the use and enjoyment of the Claimants' investment and by failing to grant the necessary permits to carry out an investment already authorized; and
(iv) Article 4 of the BIT by expropriating their investment.

In essence the issues under dispute were the following: what was the significance to be attached to the approvals of the FIC and the execution of the Foreign Investment Contracts (*i.e.* creating legitimate expectations that the project would be granted necessary approvals or a mere decision on the legality of inflow of foreign capital), whether *MTD* had been warned of the risks relating to the zoning change, whether *MTD* otherwise had exercised due diligence in making its investment.

Article 2(2) of the applicable BIT required that *"Investments of investors of either Contracting Party shall at all time be accorded fair and equitable treatment*". The Croatia BIT provided further that the right to fair and equitable treatment shall *"not be hindered in practice"* (Article 4(1)).

The Tribunal noted that being a Tribunal established under the BIT, it was obliged to apply the provisions of the BIT and interpret them in accordance with the norms of interpretation established by the Vienna Convention on the Law of the Treaties, which is binding on the State parties to the BIT. Article 31(1) of the Vienna Convention requires that a treaty be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The Tribunal found that in their ordinary meaning, the terms "fair" and "equitable" used in Article 3(1) of the BIT mean "just", "even-handed", "unbiased", "legitimate". As regards the object and purpose of the BIT, the Tribunal referred to its Preamble where the parties state their desire "to create favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party", and the recognition of "the need to protect investments by investors of both Contracting Parties and to stimulate the flow of investments and individual

business initiative with a view to the economic prosperity of both Contracting Parties". Hence, in terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a pro-active statement –"to promote", "to create", "to stimulate"- rather than prescriptions for a passive behaviour of the State or avoidance of prejudicial conduct to the investors.

The Tribunal also adopted as its standard the standard suggested by the Tribunal in the *TECMED S.A. v. The United Mexican States* case:

> "to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation".[13]

Taking account of, *inter alia*, the ministerial membership of the FIC, the duty of Chilean state organs to act coherently and to apply its policies consistently, and of the fact that the State under international law is to be considered as a unit, the Tribunal was satisfied, based on the evidence presented to it, that approval of an investment by the FIC for a project that was against the urban policy of the Government, amounted to a breach of the obligation to treat an investor fairly and equitably.

As regards compensation the Tribunal noted that the BIT provided for "prompt, adequate and effective" compensation for expropriation. However, the BIT did not provide for any standard for compensation for breaches of the BIT on other grounds, including fair and equitable treatment. As a starting point, the Tribunal used the standard pronounced by the Permanent Court of Justice in the *Chorzów Factory*

13 *Técnicas Medioambientales TECMED S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)00/2, award dated May 29, 2003, para. 154.

case*, viz.,* that the compensation should *"wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed"*.[14]

Based on this principle the Tribunal concluded that the expenditures relating to Claimant's investment in Chile, which were eligible for purposes of the calculation of damages amounted to approximately US$ 21.5 million. Such expenditures could have been avoided, had there been no breach of the fair and equitable treatment standard.

The Tribunal also underlined, however, that Chile was not responsible for the consequences of unwise business decisions or for the lack of diligence of the investor. Its responsibility was limited to the consequences of its own actions to the extent they breached the obligation to treat the Claimants fairly and equitably. In this respect the Tribunal observed, *inter alia,* that no specialist on urban development had been contacted by the Claimants until the deal was closed, that the Claimants apparently did not appreciate the fact that their JV-partner may have had a conflict of interest with the Claimants, that they seemed to have accepted his judgment, that MTD was in a hurry to start the Project, that BITs are not an insurance against business risks, and that the Claimants, as experienced businessmen, must bear the consequences of their own actions. Their choice of partner, the acceptance of a land valuation based on future assumptions without protecting themselves contractually in case the assumptions would not materialize, including the issuance of the required development permits, were risks that the Claimants took irrespective of Chile's actions. Therefore, the Tribunal awarded only 50 per cent of eligible expenditures resulting from the fact that the zoning legislation was not changed.

The starting point for the Tribunal was thus the concept of "full reparation" as laid down in the *Chorzow Factory* case and in the ILC Articles On State Responsibility. The more interesting aspect of the Tribunal's reasoning is the fact that it reduced the amount eligible for compensation by 50 per cent. The percentage as such would seem to be the result of the Tribunal exercising its discretion in determining the amount of compensation. The justification for the reduction could be explained in either of the following ways. *First*, it is possible that the Tribunal took the view that the Claimants had not established a causal link between the violation of the fair and equitable treatment standard going beyond 50 per cent of the expenditures. Put differently: part of the injury was the result of Claimants' own doing. In the view of the Tribunal, the Claimants had not in all respects acted as a prudent investor. The consequences of such conduct had to be borne by the Claimants themselves.

Second, an alternative explanation – but to a large extent, the other side of the same coin – would be to view Claimants' conduct as a case of contributory negligence. In other words, the Claimants themselves had contributed to their own misfortune. To the extent that this was the case, the host state could not be held responsible.

14 See note 10, supra.

2. CMS v. Argentine

The second ICSID case is *CMS Gas Transmission Company v. The Argentine Republic*[15] In this case the Argentinean company TGN had been granted a license for the transportation of gas. Investors had been invited to invest in the shares of *TGN*. The American company *CMS* acquired 29.42 per cent of the shares.

Under the arrangements made for the privatization of this sector of the Argentinean economy, tariffs were to be calculated in US dollars and expressed in pesos at the exchange rate at the time of billing. They were also to be adjusted semi-annually in accordance with the United States Producer Price Index (the "US PPI"). Following the major economic and financial crisis in the country, the Republic of Argentina enacted, starting late 1999, various measures which had, in the Claimant's view, an adverse impact on its business and breached the guarantees (*i.e.* the legal regime created by the gas legislation and regulations as well as the terms of the license) which were intended to protect its investment in *TGN*. These measures later led to the devaluation of the peso and the adoption of additional financial and administrative measures also alleged to have had an adverse impact on the investor.

The Claimant was of the view that the measures adopted by the Argentine Government were in violation of the commitments that the Government made to foreign investors in the offering memoranda, relevant laws and regulations and the license itself. Such commitments, it was asserted, included the calculation of tariffs in US dollars, the semi-annual adjustment in accordance with the US PPI and a general adjustment of tariffs every five years, all with the purpose of maintaining the real dollar value of the tariffs. The Claimant argued that Argentina further agreed expressly not to freeze the tariff structure or subject it to further regulation or price controls; and that in the event that price controls were introduced, *TGN* would be compensated for the difference between the tariff it was entitled to and the tariff actually charged. Moreover, the basic rules governing the license could not be altered without *TGN*'s consent. The Claimant was of the view that these guarantees constituted essential conditions for *CMS*'s investment and that it had an acquired right to the application of the agreed tariff regime.

The Claimant argued, *inter alia,* that Argentina had breached the fair and equitable standard insofar as it had profoundly altered the stability and predictability of the investment environment, an assurance that was key to *CMS'*s decision to invest.

Quoting the preamble of the Argentina – US BIT – that fair and equitable treatment is desirable "*to maintain a stable framework for investments and maximum effective use of economic resources*" – the Tribunal found that a stable legal and business environment was an essential element of fair and equitable treatment. The Tribunal found that the measures complained of did in fact entirely transform and alter the legal and business environment under which the investment was decided and made. The Tribunal further noted that a significant number of treaties show that

15 ICSID Case No. ARB/01/8, Award of 12 May 2005.

fair and equitable treatment was inseparable from stability and predictability and that the law of foreign investment and its protection had been developed to avoid adverse legal effects when specific commitments had been made. The Tribunal also observed that this was an objective requirement unrelated to whether the Respondent had had any deliberate intention or bad faith in adopting the measures in question.

Turning to compensation, the Tribunal initially noted that under international law that are three main forms of reparation for injury: restitution, compensation and satisfaction.[16] It ruled out "satisfaction" since the case was not of reparation due to an injured State. As regards "restitution" the Tribunal noted, by reference to the *Chorzów Factory* case, that this is the standard used to re-establish the situation which existed before the wrongful act was committed, provided that this is not materially impossible and does not result in a burden out of proportion as compared to compensation.[17]

As regards "compensation" the Tribunal stated that it is designed to cover any financial assessable damage including loss of profits insofar as it is established, and that it is only called for when the damage is not made good by restitution.[18] Quoting the decision in the *Lusitania* case[19], the Tribunal held that the remedy should be commensurate with the loss, so that the injured party may be made whole.[20] The Tribunal was thus inclined to award full compensation for a violation of the fair and equitable treatment standard.

However, when discussing the methods to determine and calculate compensation the Tribunal stated that "[d]epending on the circumstances, various methods have been used by tribunals to determine the compensation which should be paid but the general concept upon which commercial valuation of assets is based is that of 'fair market value.'"[21]

The Tribunal continued to say that:

> "Four ways have generally been relied upon to arrive at such value. (1) the 'asset value' or the 'replacement cost' approach which evaluates the assets on the basis of their 'break-up' or their replacement cost; (2) the 'comparable transaction' approach which reviews comparable transactions in similar circumstances; (3) the 'option' approach which studies the alternative uses which could be made of the assets in question, and their costs and benefits; (4) the 'discounted cash flow' ('DCF') approach under which the valuation of the assets is arrived at by determining the present value of fu-

16 The Award, para. 399.
17 The Award, para. 400.
18 The Award, para. 401.
19 *Lusitania*, RIAA, Vol. VII, 1923, p. 32.
20 The Award, para. 401.
21 The Award, para. 402.

> ture predicted cash flows, discounted at a rate which reflects various categories of risk and uncertainty."[22]

Having concluded that reparation by way of restitution was not an alternative for the Tribunal in the present situation, because such restitution would require a settlement between the parties, the Tribunal went on to analyze the issue of compensation.[23] It appears that the path eventually chosen by the Tribunal was the method commonly used when determining compensation for expropriation.

> "[T]he cumulative nature of the breaches discussed here is best dealt with by resorting to the standard of fair market value. While this standard figures prominently in respect of expropriation, it is not excluded that it might also be appropriate for breaches different from expropriation if their effect results in important long-term losses."[24]

The Tribunal had no problem in finding that the standard of compensation to be used was that of the fair market value. Likewise, it did not hesitate to use the discounted cash flow (DCF) method as the most appropriate method to calculate the compensation. The decisive factor in this respect seems to have been that *TGN* was a going concern. *TGN*:s license was valid until 2027. With a view to determining the actual loss of the Claimant resulting from the violation of the fair and equitable treatment standard, the Tribunal had to compare two scenarios. The first scenario involved the evaluation of revenue, cash and profits until 2027 on the assumption that there had been no change in the regulatory environment. The second scenario involved the same evaluation based on the new regulatory framework.[25] The Tribunal's reasoning makes it clear that, in this particular case, it concluded that the fair market value and the DCF methodology was the most appropriate way to determine the actual loss of the Claimant. It may also be noted that all experts consulted in the case agreed with this approach.[26]

3. Azurix Corp v. Argentine

In *Azurix Corp v. The Argentine Republic*[27], decided on 14 July 2006, the *Azurix*-Group of the US (at the time of the investment owned by *Enron)* participted in the privatization of water services in the Province of Buenos Aires (the Province). The investment was carried out through a local Argentinian company, *Azurix* Buenos

22 The Award, para. 403.
23 Cf. Articles 35-36 of ILC's Articles on State Responsibility.
24 The Award, para. 410.
25 See Award, paras. 419, 422.
26 The Award, para. 421.
27 ICSID Case No. ARB/01/12, Award of 14 July 2006.

Aires S.A. (ABA), which was incorporated to act as the concessionaire after the *Azurix*-Group won the bid for the water service concession (the Concession). After ABA had made a so-called Canon Payment of 438,555,554 Argentine Pesos on 30 June 1999, ABA and the Province executed a 30-year concession agreement. The concession was overseen and regulated by a regulatory authority established for the purpose - Organismo Regulador de Aguas Bonaerense ("ORAB").

In the arbitration, the Claimant argued, *inter alia,* that the Respondent had violated its obligation, under the U.S.-Argentina BIT, of fair and equitable treatment. The Claimant stated that such measures consisted of actions and omissions of the Province or its instrumentalities that resulted in the non-application of the tariff regime of the Concession Agreement for political reasons; that the Province did not complete certain works that were to remedy historical problems and were to be transferred to the concessionaire upon completion; that the lack of support for the concession regime prevented ABA from obtaining financing for its operations; that in 2001, the Province denied that the Canon Payment was recoverable through tariffs; and that "*political concerns were always privileged over the financial integrity of the Concession*".[28] As a result ABA had been forced to give notice of termination of the Concession and file for bankruptcy, since it was faced with no hope of recovering its investments in the "*politicized regulatory scheme*".[29]

The Respondent, on the other hand, argued that the dispute was a contractual dispute, and that the difficulties encountered by ABA in the Province were of its own making. In particular, Argentina argued that the case presented by the Claimant was intimately linked to *Enron*'s business practices and its bankruptcy; that the price paid for the Concession was excessive and opportunistic and related to the forthcoming IPO of *Azurix* at the time *Azurix* bid for the Concession and that ABA did not comply with the Concession Agreement.

Article II(2)(a) of the applicable BIT provided that "[i]nvestment shall at all times be accorded fair and equitable treatment,…and shall in no case be accorded treatment less than required by international law".

The Tribunal noted that the BIT is an international treaty that should be interpreted in accordance with the norms of interpretation established by the Vienna Convention, which is binding on the state parties to the BIT.[30] Article 31(1) of the Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".

The Tribunal found that it follows from the ordinary meaning of the terms fair and equitable and the purpose and object of the BIT that fair and equitable should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The text of the BIT reflects a positive

28 The Award, para. 43.
29 The Award, para. 43.
30 The Award, para.. 307.

attitude towards investment with words such as "promote" and "stimulate". Furthermore, the parties to the BIT recognize the role that fair and equitable treatment plays in maintaining "a stable framework for investment and maximum effective use of economic resources".[31]

The Tribunal also found that except for *Genin v. Estonia*,[32] there is a common thread in the recent awards under NAFTA and in *Tecmed v. Mexico,*[33] to the effect that bad faith or malicious intention of the recipient State is not a necessary element in the failure to treat investments fairly and equitably. The Tribunal concurred with the Tribunal in *CMS*, which stated that fair and equitable treatment is an objective standard "unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard."[34]

As to the question whether the standard of fair and equitable treatment had been breached, the Tribunal said that it was:

> "struck by the conduct of the Province after the the Claimant gave notice of termination of the Concession Agreement. ABA had requested to terminate the agreement in agreement with the Province. The Province refused what was a reasonable request in light of the previous behavior of the Province and its agencies. The refusal by the Province to accept that notice of termination and its insistence on terminating it by itself on account of abandonment of the Concession is a clear case of a breach of the fair and equitable treatment standard. It is evident from the facts before this Tribunal that the Concession was not abandoned."[35]

The Tribunal countinued to say that:

> "Although the Tribunal has rejected to a certain extent the interpretations of the Concession Agreement and the Law alleged by the Claimant regarding the RPI and the Canon, it is also clear that the tariff regime was politicized because of concerns with forthcoming elections or because the Concession was awarded by the previous government. The issues of the zoning coefficients and the construction variations are cases in point. It is significant that, once the service was transferred, the new service provider was allowed to raise tariffs reflecting the construction variations.

31 The Award, para. 307.
32 *Genin*, *Eastern Credit Limited*, *Inc. and A.S. Baltoil* v. *Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001.
33 *Técnicas Medioambientales TECMED S.A.* v. *The United Mexican States*, ICSID Case No. ARB(AF)00/2, Award, 29 May 2003.
34 The Award, para. 372.
35 The Award, para. 374.

> Finally, the repeated calls of the Provincial governor and other officials for non-payment of bills by customers verges on bad faith in the case of the Bahía Blanca incident when the Province itself had not completed the works that would have helped to avoid the problem in the first place.
>
> Considered together, these actions reflect a pervasive conduct of the Province in breach of the standard of fair and equitable treatment."[36]

As regards the question whether Argentina in addition to the above had also taken measures that could be considered to be arbitrary and to have impaired "*the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal*"[37] of the investment of *Azurix* in Argentina, the Tribunal found that the actions of the provincial authorities calling for non-payment of bills even before the regulatory authority had made a decision, threatening the members of the ORAB because it had allowed ABA to resume billing, requiring ABA not to apply the new tariff resulting from the review of the construction variations and affirming that zone coefficients apply in contradiction with the information provided to the bidders at the time of bidding for the Concession, restraining ABA from collecting payment from its customers for services rendered before March 15, 2002, and denying to ABA access to the documentation on the basis of which ABA was sanctioned were arbitrary actions without any support in the Law or the Concession Agreement and impaired the operation of *Azurix'*s investment.[38]

Turning to compensation, the Tribunal concluded that the BIT did not provide any measure of compensation apart from cases of expropriation. The Tribunal referred to the *CMS v. Argentina* case (Section 3.2.2 above), in which the tribunal found that the standard of fair market value, which frequently figures in respect of expropriation, may be appropriate also for other breaches if their "*effect results in important long-term losses*".[39] Turning to the facts of the present case, the Tribunal found that "compensation based on the fair market value of the Concession would be appropriate, particularly since the Province has taken it over".[40] In measuring the fair market value, the Tribunal stated that the function of the Tribunal is "to try and determine what an independent and well-informed third party would have been willing to pay for the Concession in March 2002, in a context where the Province would have honoured its obligations".[41]

36 The Award, para. 375-377.
37 Article II.2(b) of the US-Argentina BIT provides: "Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments".
38 The Award, para. 390-393.
39 The Award, para. 420.
40 The Award, para. 424.
41 The Award, para. 427.

The Claimant had submitted two methodologies for determining the fair market value: the actual investment and the book value. The Tribunal agreed with the Claimant that "*the actual investment method is a valid one in this instance*".[42] The Tribunal found that the Claimant's investment in this respect was the price paid for the Concession and the additional investments made to finance ABA.

The Tribunal emphasised, however, that a significant adjustment was required to arrive at the real value of the Canon paid by the Claimant for the Concession. According to the Tribunal, no well-informed investor would at the time of the violation have paid for the Concession the price (and more particularly, the Canon) paid by *Azurix* in mid-1999, irrespective of the actions taken by the Province and of the economic situation of Argentina at that time.[43] The primary reason for this conclusion of the Tribunal appears to have been the Tribunal's findings with regard to the tariffs and tariff adjustment review provided by the Concession Agreement. The Claimant argued that under the Concession Agreement the Canon Payment should be included in the asset base that the concessionaire had the right to recover through the tariffs to be applied to the concessionaire's services under the Concession Agreement. However, in the view of the Tribunal, the Canon Payment could not be included as a recoverable asset base for the purpose of tariff increases.[44]

In light of the above factors, the Tribunal concluded that no more than a fraction of the Canon Payment could realistically have been recuperated under the existing Concession Agreement. The Tribunal therefore found that the value of the Canon at the time of the violation should be established at 60,000,000 US dollars. The Tribunal did not explain, however, how it arrived at this amount. The full Canon Payment made by the Claimant amounted to 438,555,551 US dollars.[45]

It should also be noted that the Tribunal did not award any compensation for unpaid bills owed by customers to ABA, which the Province had directed the customers not to pay, since the Tribunal found that this amount was owed by the Province to ABA and, therefore, should not be part of the compensation awarded to *Azurix*.[46] Nor did the Tribunal award compensation for certain expenditures incurred by the Claimant in connection with negotiations with the Province and the termination of the Concession, since the Tribunal found that it had not received sufficient evidence in support of such costs and that, in any case, these were costs related to the business risk that *Azurix* took when it decided to make the investment. Therefore, although agreeing in principle that compensation should wipe out the consequences of an illegal act, in the circumstances of this particular case, the Tribunal did not find the amount claimed to be justified.[47]

42 The Award, para. 425.
43 The Award, para. 426.
44 The Award, para. 427.
45 The Award, para. 429.
46 The Award, para. 431.
47 The Award, para. 432.

III. Cases Decided by Other Tribunals

1. Nykomb Synergetics Technology Holding AB v. Latvia[48]

Nykomb v. the Republic of Latvia was the first award on the merits rendered under the ECT. It was rendered on 16 December 2003 and concerned a dispute regarding the purchase of power by the state-owned Latvian company, *Latvenergo*, and the Latvian company *Windau,* a wholly owned subsidiary of the Swedish company *Nykomb*. *Latvenergo* and *Windau* entered into several agreements, according to which *Windau* would build a co-generation electric plant and *Latvenergo* would purchase the surplus electricity produced subsequently. *Windau* and *Latvenergo* had a dispute over *Windau*'s tariff. *Nykomb* argued that *Windau* was entitled to a double tariff in accordance with the Entrepreneurial Law in force at the time when the contract in question was concluded, whereas *Latvenergo* claimed that *Windau* only was entitled to a lower tariff in accordance with subsequent legislation that had amended the Entrepreneurial Law.

As to the merits of *Nykomb*'s claim, the Tribunal found that Latvia had breached its obligation under Article 10 of the ECT[49] not to discriminate against foreign investors by offering the so-called "double tariff" to certain other companies but not to *Nykomb*'s Latvian subsidiary, *Windau*, and by failing to present any evidence why those companies were different.

As to the standard of compensation applicable in case of such discrimination, the Tribunal noted that the principles of compensation provided for in Article 13(1) of the ECT, in case of expropriation, were not applicable to the assessment of damages or losses caused by violations of Article 10. The Tribunal found that "the question of remedies to compensate for losses or damages caused by the Respondent's violation of its obligations under Article 10 of the Treaty must primarily find its solution in accordance with established principles of customary international law. Such princi-

48 Stockholm International Arbitration Review, 2005:1, p. 53. See further *T. Wälde* and *K. Hobér*, The First Energy Charter Award, Journal of International Arbitration, Vol. 22, No. 2 (2005), pp. 83–103.

49 Article 10 (1) of the ECT reads as follows: "Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use enjoyment or disposal. In no such case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party."

ples have authoritatively been restated in The International Law Commission's Draft Articles on State Responsibility adopted in November 2001".[50]

The Tribunal further noted that according to Articles 34[51] and 35[52] of the ILC Articles, restitution was the primary remedy. However, with respect to the case before it, the Tribunal found that restitution was a suitable remedy primarily where the state had instituted actions directly against the investor. Where the actions were directed against its subsidiary, the Tribunal instead found the appropriate remedy to be compensation for the losses or damage inflicted on the investor's investment.[53]

Nykomb claimed damages corresponding to the difference between the "double tariff" and the tariff that had actually been paid to *Windau.* However, the Tribunal decided not to give *Nykomb* the full difference between the two sets of tariffs because the higher payments would not have gone directly to *Nykomb* but to *Windau.* The Tribunal stated that "the money would have been subject to Latvian taxes etc., would have been used to cover *Windau*'s costs and down payments on *Windau*'s loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends".[54]

Taking into account the requirements under applicable customary international law of causation, foreseeability and the reasonableness of the result, the Tribunal nevertheless found that the reduced earnings of *Windau* constituted the best available basis for the assessment also of *Nykomb*'s losses. It came to the conclusion that a discretionary award of one third of the estimated loss in purchase prices of electricity up to the time of the award would serve as a reasonable basis for the quantification of *Nykomb*'s assumed losses up to the time of the award.[55]

As regards *Nykomb*'s alleged losses on delivery of electric power to *Latvenergo* for the remainder of the eight year contract period, the Tribunal found this potential loss too uncertain and speculative to form the basis of an award of monetary compensation. The Tribunal, however, considered it to be a continuing obligation of Latvia to ensure payment at the double tariff for electric power delivered under the contract for the rest of the eight year contract period. It therefore ordered Latvia to

50 Stockholm International Arbitration Review, 2005:1, p. 104-105.

51 "Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of the chapter."

52 "A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:
(a) Is not materially impossible;
(b) Does not involve a burden out of all proportion to the benefits deriving from restitution instead of compensation".

53 Stockholm International Arbitration Review, 2005:1, p. 105-108.

54 Stockholm International Arbitration Review, 2005:1, p. 105.

55 Stockholm International Arbitration Review, 2005:1, p. 107.

fulfil its obligation to pay the double tariff for future deliveries during the remainder of the contract period.[56]

2. Petrobart Limited v. Kyrgyzstan[57]

The second arbitral award on the merits rendered under the ECT was between *Petrobart Ltd* of Gibraltar and the Kyrgyz Republic. It concerned a sales contract between Petrobart and the Kyrgyz state owned company *KGM* for the purchase by the latter of 200,000 tonnes of gas condensate. The award was rendered on 29 March 2005.[58]

Petrobart delivered five shipments of gas but was only paid for the first two. At the same time as *Petrobart* turned to domestic courts for recourse, Kyrgyz authorities – as part of a reform of the system for supply of oil and gas in the Kyrgyz Republic –took certain measures that made it impossible for *Petrobart* to enforce its rights under the contract. The measures included a decision by the Kyrgyz authorities to privatize *KGM*, and to transfer its assets, but not its liabilities (including monies owed to Petrobart), to a new company as well as a request by the Vice Prime Minister of the Kyrgyz Republic who – referring to *KGM*'s critical financial standing – asked the chairman of the Kyrgyz court that previously had rendered a judgment in favour of *Petrobart*, to assist in granting a stay of the enforcement of the judgment against *KGM*. Enforcement was stayed by the court referring to the letter of the Vice Prime Minister, and before the period of stay of execution ended, *KGM* was declared bankrupt, which meant that enforcement of the judgment was no longer possible.

The Tribunal found that the Kyrgyz Government was liable for certain breaches of the ECT, specifically by virtue of its failure to provide fair and equitable treatment by transferring assets from *KGM* to the above mentioned new company to the detriment of KGM's creditors, including *Petrobart* (Article 10(1)); and by intervening in court proceedings regarding the stay of execution of a final judgment to the detriment of *Petrobart* (Article 10(12)).[59]

The Tribunal found that the Kyrgyz Republic had violated its obligations under Articles 10(1) and 10(12) of the ECT. With reference to the *Chorzów Factory* case and to ILC's Articles on State Responsibility, the Tribunal found that *Petrobart* had

56 Stockholm International Arbitration Review, 2005:1, p. 108.

57 The full text of the award is available e.g. at http://www.investmentclaims.com/decisions /Petrobart-kyrgyz-rep-Award.pdf.

58 The award was challenged at the Svea Court of Appeal in Stockholm, but the challenge was rejected.

59 Petrobart Limited *v.* the Kyrgyz Republic, p. 76. Article 10(12) of the ECT reads as follows: "Each Contracting Party shall ensure that its domestic law provides effective means for the assertion of claims and the enforcement of rights with respect to Investments, investment agreements, and investment authorizations".

suffered damage as a result of the Kyrgyz Republic's breaches of the ECT and that *Petrobart* had to, as far as possible be placed financially in the position in which it would have found itself, had the breaches not occurred.[60]

Petrobart essentially claimed compensation for (i) the unpaid invoices for gas condensate actually delivered by Petrobart to KGM; and (ii) loss of profit with regard to the remaining deliveries under the contract.

The Tribunal found that due to the troublesome financial situation of *KGM*, *KGM* would probably not have survived irrespective of the breaches of the ECT committed by the Kyrgyz Republic.[61]

The Tribunal nevertheless found that the transfer by the Kyrgyz Republic of substantial assets belonging to *KGM* to other state entities caused substantial damage to *KGM*'s creditors, including *Petrobart*. Due to the inadequacy of the information submitted by the parties, the Tribunal found that the damage suffered by *Petrobart* could not be established with precision. The Tribunal therefore found it necessary to make a general assessment based on its appreciation of the situation as a whole. In making such assessment, the Tribunal found that the Kyrgyz Republic "as responsible for the transfer and lease of *KGM*'s assets, shall compensate *Petrobart* for damage which the Arbitral Tribunal estimates at 75% of its justified claims against *KGM*".[62]

With regard to *Petrobart*'s claim for lost profit, the Tribunal found that there remained a great deal of uncertainty as to the consequences of the breakdown of the business relations between *Petrobart* and *KGM*. The Tribunal therefore concluded that *Petrobart* had not established that it was entitled to compensation for loss of future profits.[63]

Since most of the respective Tribunals' findings regarding damages in *Nykomb* and *Petrobart* are rather fact specific, only limited conclusions can be drawn from such cases. It should be noted, however, that in the absence of express provisions on the standard of compensation, the Tribunals in both cases relied on general provisions of customary international law on state responsibility.

It could also be noted that in *Nykomb*, where the investment – the local subsidiary *Windau* – was still in operation and the contract for delivery of electric power still in force between *Windau* and *Latvenergo,* the Tribunal made a clear distinction between the damage suffered by *Nykomb* – the foreign investor – and the damage suffered by *Windau.* The Tribunal only awarded damages that would compensate *Nykomb* for the damage, that it had actually suffered, and not for losses suffered by *Windau*. *Nykomb*'s damage was quantified as a proportion of the earnings that would have been generated by Windau, had there not been any breach of the treaty, *i.e*. the Tribunal estimated the dividends that would have been received by *Nykomb*

60 Petrobart Limited v. the Kyrgyz Republic, p. 77-78.
61 Petrobart Limited v. the Kyrgyz Republic, p. 81.
62 Petrobart Limited v. the Kyrgyz Republic, p. 83-84.
63 Petrobart Limited *v.* the Kyrgyz Republic, p. 86-87.

from its subsidiary, rather than establishing a reduction of the value (if any) of Nykomb's shares in Windau.

3. S.D. Myers, Inc. v. Canada

In *S.D. Myers, Inc. v Canada*[64], S.D. Myers, Inc (*SDMI*) (USA) claimed that Canada had failed to comply, *inter alia*, with its obligation under Article 1105 of the NAFTA[65] to treat investors of another party to the NAFTA in accordance with international law, including fair and equitable treatment. *SDMI,* an Ohio corporation that processed and disposed of PCB waste, alleged that Canada's ban on the export of *PCB* wastes from Canada to the United States in late 1995 had resulted in *SDMI* suffering economic harm to its investment through interference with its operations, lost contracts and opportunities in Canada.

In its first Partial Award of 13 November 2000 the Tribunal held that Canada had breached the fair and equitable treatment obligation of Article 1105 of the NAFTA. As regards the principles for compensation the Tribunal stated that in non-expropriation cases the drafters of the NAFTA had left "it open to Tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of the NAFTA".[66] The Tribunal further concluded that in some non-expropriation cases a Tribunal might find it appropriate to adopt the fair market approach and in some not. In this case the Tribunal found that the fair market value standard was not a logical, appropriate or practicable measure of the compensation to be awarded. Instead the Tribunal cited the *Chorzów Factory* case and stated that "whatever precise approach is taken, it should reflect the general principle of international law that compensation should undo the material harm inflicted by a breach of an international obligation".[67] Further, the Tribunal made clear that it was for *SDMI* to prove the quantum of the losses. The Tribunal also stated that compensation is payable only in respect of harm that is proved to have a sufficient casual link with the specific NAFTA provision that has been breached, and that double recovery must be avoided in situations *e.g.* when several NAFTA provisions have been breached.[68]

In the second Partial Award of 21 October 2002 the Tribunal held that "the appropriate loss to be considered in this particular case is the loss of net income stream".[69] The Tribunal noted that this approach formed part of the submissions of

64 8 ICSID Reports (2005) 18.

65 Article 1105(1) of NAFTA reads as follows: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security".

66 First Partial Award para. 309.

67 First Partial Award para. 315.

68 First Partial Award para. 317.

69 Second Partial Award, para. 100.

both parties and, further, that expert accountants retained by both sides agreed that *SDMI*'s lost income stream was capable of rational assessment.

In order to asses the compensation due to *SDMI* as a result of Canada's export ban on *PCB* the Tribunal used a 12-step methodology aimed at determining the net income stream lost by SDMI plus compensation for abridged opportunity and delay.[70] The Tribunal finally determined the total compensation (excluding interest) by using this methodology to CAN$6,050,000.

4. Marvin Feldman v. Mexico

Marvin Feldman v. Mexico[71], concerned a dispute regarding the application of certain Mexican tax laws to the export of tobacco products by *CEMSA*, a company organized under the laws of Mexico and owned and controlled by the Claimant, Mr. *Feldman*. The Claimant alleged that Mexico's continuing refusal to recognize *CEMSA*'s right to a refund of certain Mexican taxes in connection with cigarette exports constituted a breach of Mexico's obligations under Chapter Eleven of NAFTA.

In most instances, when cigarettes were purchased in Mexico at a price that included tax, and subsequently exported, the tax amounts initially paid could be refunded. However, in 1991 the law was changed so that only producers – not resellers such as Claimant – became eligible for the refund. Subsequently, resellers again became eligible for the refund, but the Claimant did not manage to meet statutory invoice requirements, as the invoices from the volume retailers, from which the Clamiant purchased, did not itemize the tax on the invoice. This eventually forced Claimant to shut down its business.

Claimant argued, *inter alia,* that Mexico discriminated against *CEMSA*, since Mexican authorities permitted at least three Mexican owned resellers of cigarettes to export cigarettes and to receive refunds, notwithstanding the fact that like the Claimant, they purchased their goods from retailers, and, thus, could not have invoices stating the tax amounts separately.

The majority of the Tribunal found that the evidence available supported that the Claimant was denied the refunds at a time when at least three Mexican companies in like circumstances, i.e. resellers and exporters, were granted them. The majority therefore found that Mexico had violated the Claimant's right to non-discrimination under Article 1102 of NAFTA.[72]

Concerning the quantum of damages to be awarded to the Claimant, the Tribunal observed that NAFTA provides no guidance as to the proper measure of damages or compensation for situations that do not fall under Article 1110 (expropriation). The

70 Second Partial Award, para. 229.
71 ICSID Case No. ARB(AF)/99/1, Award 16 December 2002.
72 The Award, para. 173 *et seq*.

Tribunal found that "in case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110".[73] The Tribunal, thus, dismissed the Claimant's claim for compensation equivalent to *CEMSA*'s "going concern value", because compensation for the full market value of *CEMSA* would require a finding of expropriation.[74] Since, most parts of the Claimant's claim for loss of profits were time barred under NAFTA Article 1117(2), the only thing that remained of Claimant's claim was three months tax refunds relating to the period after the cut-off date. Compensation for such claim was awarded by the Tribunal with 9,464,627.50 Mexican pesos (about 946,462 U.S. dollars) after certain adjustments for miscalculations and reductions for amounts relating to cigarettes exported to tax havens, since the latter amounts would not have been eligible for refunds under Mexican law.[75]

5. Pope & Talbot Inc. v. Canada

In *Pope & Talbot Inc. v. Canada*[76], Pope & Talbot claimed that Canada's implementation of the 1996 Softwood Lumber Agreement (SLA) between Canada and the US, which among other things regulated the export of softwood lumber from Canada to the US, *inter alia,* violated Article 1105 of the NAFTA, according to which parties have an obligation to treat investors of another party to the NAFTA in accordance with international law, including fair and equitable treatment. Under the SLA export fees were levied on exports of softwood lumber out of Canada to the U.S., unless the exports came within a certain annual quota for all such softwood lumber exports. There was also a certain export quota on which a lower fee was levied. *Pope & Talbot* alleged that a number of measures taken by Canada with regard to the allocation of the above export quotas violated Article 1105.

The tribunal found that whereas Canada's quota allocations were handled in a reasonable manner, the handling of a certain "verification review procedure" regarding information underlying *Pope & Talbot*'s quota applications initiated by Canada's Softwood Lumber Division (SLD), constituted a denial of the investor's fair treatment required by NAFTA Article 1005. In the view of the Tribunal, the actions undertaken by SLD meant that *Pope & Talbot* was subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense

73 The Award, para. 194.
74 The Award, para. 198.
75 The Award, para. 202 *et seq*.
76 UNCITRAL Award, 10 April 2001, www.investmentclaims.com.

and disruption in meeting SLD:s requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles.[77]

In its award on damages[78], the Tribunal did not expressly discuss the standard of compensation to be applied in case of violations of fair and equitable treatment under NAFTA Article 1105. In light of the Tribunal's conclusions with regard to liability, the Tribunal simply awarded the investor compensation for costs and expenses incurred due to SLD:s "verification review procedure", which primarily included accountants' and legal fees as well as expenses incurred in lobbying efforts.[79] The Claimant's claim for compensation for the value of management time devoted to the "verification review procedure" was denied, since the Tribunal found management costs to be a fixed cost that the Claimant would have had irrespective of the "verification review procedure".[80]

D. Concluding Remarks

As mentioned above there are few arbitral awards dealing with the issue of compensation for violations of the fair and equitable treatment standard. This means that caution is required when trying to draw general conclusions from such awards. It is submitted that it is in fact too early to draw any general conclusions at all. The cases discussed in this contribution show that there is, for the time being, no general approach to this issue. Only time will tell if there will ever be such a general approach. This notwithstanding, some preliminary observations come to mind.

First, given the absence of treaty provisions in this area, tribunals rely – as they must – on customary international law. Guidance is usually sought from the ILC Articles on State Responsibility which in turn build on the principles laid down in the *Chorzow Factory* case. This is, however, only the first step in that it establishes the *standard* of compensation. As stated in Article 31 of the ILC Articles the standard is "full reparation"

Second, when it comes to the *method* of establishing and calculating "full reparation", customary international law does not provide much guidance. The cases discussed above illustrate that the method chosen depends on, and varies with, the circumstances of each individual case, including, *inter alia*, the nature of the violation of the fair and equitable treatment standard and the kind and nature of the investment in question. Sometimes the starting point might be the amount actually invested, in other cases it might be more appropriate to focus on lost future profits as established by using the DCF method.

77 The Award, para. 181.
78 UNCITRAL Award, 31 May 2002, www.investmentclaims.com.
79 The Award, para. 85.
80 The Award, para. 82.

Third, it would seem that the issue of causality has the potential of creating more problems in this context than in relation to compensation for expropriation. One possible explanation is that violation of the fair and equitable treatment standard does not automatically result in the elimination of the investment, as is mostly the case with expropriation, but rather results in a decline in the business in question, or in other negative impact on it. The difficulty is to determine the extent to which this is caused by the violation of the fair and equitable treatment standard.

The "Foreign Nationality"-Requirement and the "Exhaustion of Local Remedies" in Recent ICSID Jurisprudence

Richard Happ[*]

I have been asked to analyse recent jurisprudence[1] of arbitral tribunals constituted under the auspices of the "International Centre for the Settlement of Investment Disputes" (hereinafter "ICSID tribunals" or "tribunals") relating to the "foreign nationa-lity – requirement" and the rule of exhaustion of local remedies. The scope of this report is restricted to awards and decisions rendered between 2001 and 2006.

A. Introductory Remarks

I. ICSID Convention and Diplomatic Protection

The "foreign nationality"-requirement can be located in Article 25 (1) ICSID Convention[2] which sets out the general requirements for the jurisdiction of an ICSID tribunal. The exhaustion of local remedies is not something which the ICSID Convention requires. To the contrary, Article 26 ICSID Convention sets out that a Contracting State "may require the exhaustion of local remedies as a condition of its consent to arbitration under this Convention."

Both issues are not privy to the ICSID Convention, but have developed as part of the right of states to grant diplomatic protection to their nationals. States are only entitled to bring a claim on behalf of their nationals once that national has exhausted the local remedies. In the *ELSI*-case, the International Court of Justice qualified this rule as "an important principle of customary international law."[3]

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1 If not explicitly stated, the awards and decisions cited in this paper can be found on the website of ICSID at www.worldbank.org/icsid/ or at the following private websites: www.Investmentclaims.com or http://ita.law.uvic.ca/chronological_list.htm.

2 Convention on the Settlement of Investment Disputes between States and Nationals of other States, Washington, 18. März 1965, I.L.M. 4 (1965), 524; in force since 14.10.1966 (hereinafter the „ICSID-Convention").

3 1989 I.C.J. Reports 42, para. 50.

In the area of investment disputes, diplomatic protection has been factually replaced by treaty-based investment arbitration as a means of dispute settlement[4]. The current caseload of ICSID consists nearly exclusively of disputes relating to the alleged breach of a bi- or multilateral investment treaty (hereinafter "BITs").

Notwithstanding this, one must be aware that within the framework of the ICSID Convention, the foreign nationality requirement and the exhaustion of local remedies have a different function than they have within the framework of diplomatic protection. The jurisdiction of ICSID extends to all kinds of investment disputes, whether they are based on contract, national law or treaty, as long as the requirements of Article 25 (1) ICSID Convention are fulfilled. In contrast, diplomatic protection is restricted to alleged breaches of international law. Regard must be had to this different function when interpreting the ICSID Convention.

II. ICSID Convention and Investment Protection Treaties

The basis for the jurisdiction of an arbitration Tribunal is a respective agreement of the parties. Article 25 (1) ICSID Convention incorporates this by requiring the 'consent' of the parties to submit their dispute to Centre.

Where a dispute is based on a bilateral investment treaty ("BIT"), the consent of the state is contained in the dispute settlement clause of the BIT. In terms of an agreement, the dispute settlement clause constitutes the offer of the state made to nationals of the other state. The investor consents to arbitration – and accepts the offer of the state - by filing its request of arbitration. Thus, provisions in the dispute settlement clause dealing with nationality and exhaustion of local remedies become part of the arbitration agreement.[5]

An arbitration agreement must conform to the requirement of Article 25 ICSID Convention in order for an ICSID tribunal to have jurisdiction. It follows that from the perspective of the ICSID Convention, the provisions in a BIT dealing with nationality and exhaustion of local remedies are conceptually subordinated to the ICSID Convention.

4 For an analysis of that change (and some of its implications) cf. *Happ*, Schiedsverfahren zwischen Staaten und Investoren nach Artikel 26 Energiechartavertrag. Eine Studie zum Wandel der Streitbeilegung im Investitionsschutzrecht unter den Bedingungen einer globalen Weltwirtschaft (2000).

5 *Schreuer*, The ICSID-Convention: A Commentary, Article 25 mn. 481.1.

B. The "Foreign Nationality"-Requirement

I. The General Rule

Article 25 (1) ICSID Convention sets out that the
"jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre".

To fall under the jurisdiction of the Centre, a dispute must thus arise between a Contracting State and a national of another Contracting State. The nationality requirement is considered not to have the same importance as in the field of diplomatic protection. In the framework of the Convention, the 'foreign nationality'-requirement is only the means to bring an investor within the jurisdiction of the Centre[6].

In Article 25 (2) (a-b), the Convention clarifies that a "national of another Contracting State" can be an individual or a juridical person. The Convention does not define the concept of nationality. Whether an individual or a juridical person is a national of a Contracting State is, in the first instance, a matter of the law of that Contracting State[7]. The possession of the nationality of a certain state can be proven by passports and/or certificates of nationality, although tribunals are not bound by these documents. In *Hussein Nuaman Soufraki v. United Arab Emirates*[8], the Claimant had submitted certificates of nationality issued by the Italian authorities to the tribunal. While it agreed with Prof. *Schreuer* that certificates of nationality should be given appropriate weight, it noted that such documents did not preclude a contrary decision by the tribunal[9]. Analyzing the submitted documents in detail, the tribunal found no evidence that the Italian officials who issued the certificates were aware that the Claimant had lost his Italian nationality. In cross-examination, the Claimant also admitted that he had not informed any Italian official of his loss of nationality, since he himself did not believe that he had lost it. Consequently, the tribunal held that the Claimant could not rely on any of these certificates or on the letter of the Italian foreign ministry[10]. The tribunal was therefore compelled to determine for itself whether the Claimant reacquired Italian nationality after 1991. Italian law provided for that possibility, requiring only the taking up of residence in Italy for a

6 *Sinclair*, The Substance of Nationality Requirements in Investment Treaty Arbitration (yet unpublished paper), p. 3-4 (citing *Broches* and *Amerasinghe*).
7 *Schreuer*, The ICSID-Convention: A Commentary, Article 25 mn. 429, 460.
8 *Hussein Nuaman Soufraki v. United Arab Emirates*, Case No. ARB/02/7, Award of 7 July 2004 (*Fortier* (presiding), *Schwebel*, *El Kholy*). The case arose on the basis of the BIT between Italy and the United Arab Emirates.
9 *Id.*, para. 63.
10 *Id.*, para. 66-68.

period of not less than a year. Reviewing the evidence submitted, it found that the Claimant could not prove that he had fulfilled this requirement, and thus concluded that he was not an Italian national[11]. As a result, the tribunal decided that the dispute was outside its jurisdiction. The Claimant could not rely on the BIT between Italy and the United Arab Emirates.[12]

II. Nationality of Individuals

Article 25 (2) (a) ICSID Convention clarifies that the investor must not have the nationality of the Contracting State which is a party to the dispute. The ICSID Convention does not prohibit double nationality as long as the investor has the nationality of at least one Contracting State[13]. It is only where the investor has both the nationality of the host state and of another Contracting State that he will not be able to resort to ICSID jurisdiction. This proved fatal for some of the claimants in *Champion Trading et. al v. Arab Republic of Egypt*[14]. The individual claimants had both U.S. and Egypt nationality and relied on their Egyptian nationality when making the investment in Egypt. The tribunal thus held that their claims were outside its jurisdiction.

The principle of effective nationality, which the International Court of Justice had pronounced in the *Nottebohm*[15] case, seems also have to been accepted with regard to investment disputes[16]. Within the period under review, however, no ICSID tribunal seems to have issued a holding dealing with this principle. It was an issue raised by the individual claimants in *Champion Trading*, but considered not decisive since those claimants had US nationality.

Article 25 (2) (a) imposes two temporal limitations: the investor must have the nationality of another Contracting State at the time when both parties consented to ICSID jurisdiction and at the time when the request for arbitration[17] was registered. The continuous nationality - rule proclaimed by the tribunal in *Loewen v. United*

11 *Id.*, para. 81.

12 The claimant could not accept the offer made by the United Arab Emirates to nationals of Italy to submit disputes to ICSID arbitration, since he was no Italian national. The possible precedential value of the decision is thus not restricted to ICSID cases.

13 *Schreuer*, Article 25 mn. 438.

14 *Champion Trading et al. v. Arab Republic of Egypt*, Case No. ARB/02/09, Decision on Jurisdiction of 21 October 2003 (*Briner* (presiding), *Yves Fortier*, *Aynès*).

15 ICJ, *Nottebohm Case* (Lichtenstein v. Guatemala), Second Phase, Judgement of 6 April 1955, ICJ Reports 1955, p. 4 *et seq.*

16 *Schreuer*, mn. 439; *cf. Feldman Karpa v. Mexico*, Case No. ARB(AF)/99/1, Interim decision on preliminary jurisdictional issues of 6 December 2000 (*Bravo*, *Gantz*, *Kerameus*), para. 32. Cf. also *Wisner/Gallus*, JWIT 2004, 927, 930-933.

17 ICSID Arbitration is initiated by a request for arbitration, Article 36 (1) ICSID Convention.

States[18] might apply to treaty-based investment disputes. But since the ICSID system is also open for mere contractual disputes, the ICSID Convention does not require continuous nationality. The investor may change its nationality as long as he/she fulfils the requirements of Article 25 (2) (a) ICSID Convention[19]. Of course, this is without prejudice to a possible rule of continuous nationality under applicable bi- or multilateral investment treaties or customary international law[20] in a treaty-based investment dispute.

III. Nationality of Juridical Persons

1. General Rule

Article 25 (2) (b) ICSID Convention provides that a "national" is also
"any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention."

The Convention does not define the concept of "juridical person". It seems, however, to be generally accepted that legal personality is a necessary prerequisite for being a "juridical person", and that mere associations of individuals are not sufficient[21]. In *Impregilo v. Pakistan*, the Tribunal thus held that the Claimant could not bring a claim on behalf of an unincorporated Swiss joint venture, which it considered to be not a juridical person[22]. It is to be noted that several BIT's, *inter alia* the new German-Chinese BIT, provide that "investors" can also be entities without legal

18 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America*. Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*). For a critical review, see *Rubins*, Loewen v. United States: The Burial of an Investor-Statee Arbitration Claim, Arbitration International 21 (2005), 1 *set seq*.

19 *Schreuer*, Article 25 mn. 452, 453.

20 Cf. *Dugard*, Addendum to the first report on diplomatic protection, UN Doc. A/Cn.4/506/Add.1. *Dugard* concludes (on p.10): "12. The dubious status of the requirement of continuity of nationality as a customary rule is emphasized by the uncertainties surrounding the content of the alleged rule. There is no clarity on the meaning of the date of injury, nationality, continuity and the *dies ad quem* (the date until which continuity of the claim is required)."

21 *Schreuer*, Art. 25 mn. 457-459.

22 *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction of 22 April 2005 (*Guillaume* (presiding), *Cremades, Landau*), para. 132. Cf. also *Consorzio Groupement L.E.S.I. – Dipenta v. Algeria*, Award on 10 January 2005 (*Tercier* (presiding), *Faurès*, *Gaillard*), par. 34/37.

personality[23]. Those investors thus will not qualify as"juridical persons" pursuant to Article 25 (2) (b) ICSID Convention[24].

The nationality of juridical persons is primarily determined by the national law of the state whose nationality is claimed. Usually, corporate nationality is determined by the place of incorporation and/or the head office of the juridical person. These criteria have been adopted consistently by ICSID Tribunals[25]. Control of the corporation by nationals of that state is not considered a necessary criterion[26], since Article 25 (2) (b) presupposes that a juridical person has the nationality of the host state, but is controlled by nationals of another Contracting state. Provisions on nationality in national investment laws and investment treaties which provide for ICSID jurisdiction form part of the legal framework of the Contracting State party to the dispute and/or of the arbitration agreement.

2. Agreement to Treat a Juridical Person as a Foreign National

Pursuant to Article 25 (2) (b), the parties to the dispute may agree to treat a juridical person which has the nationality of the host state, but is controlled by nationals of another Contracting State, as a national of another Contracting State. Such an agreement should normally be explicit to avoid any doubts[27]. However, ICSID tribunals have been generous in assuming an implicit agreement at least in cases where the state had agreed to ICSID jurisdiction with a locally incorporated company[28]. BIT's may also contain a respective explicit offer of the State, which upon acceptance by the investor becomes part of the arbitration agreement. Absent such an explicit offer, no tacit agreement can be deduced from the conclusion of a BIT.

While parties may agree explicitly or implicitly on treating a juridical person as a foreign national, it is an objective requirement that the juridical person must be con-

23 Cf. Art. 1(2) (a) of German-Chinese BIT, pursuant to which an investor (as regards the Federal Republic of Germany) is: "any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany". An English-language version of the BIT can be found at http://www.iisd.org/pdf/2006/itn_germany_china_bit_2003.pdf.

24 It is to be noted that the German-Chinese BIT provides only for ICSID jurisdiction, unless the parties agree otherwise. Since it seems extremely unlikely that China would agree to the jurisdiction of a different forum to enable an investor to bring a claim, the consequence seems to be that only the individuals behind those entities can file a claim.

25 *Schreuer*, Art. 25 mn. 460. In the period under review, no tribunal seems to have deviated from this general rule.

26 *Schreuer*, Art. 25 mn. 463.

27 ICSID has published several model arbitration clauses. The respective clause no. 7 (to be found at: http://www.worldbank.org/icsid/model-clauses-en/9.htm#c) reads as follows: "It is hereby agreed that, although the Investor is a national of the Host State, it is controlled by nationals of name(s) of other Contracting State(s) and shall be treated as a national of [that]/[those] State[s] for the purposes of the Convention."

28 *Schreuer*, Art. 25 mn. 519.

trolled by nationals of another Contracting State. Control is primarily exercised via majority shareholding[29]. Often, the foreign national is a juridical person and only the first link in a chain of juridical persons of different nationality. In such cases, the questions arises whether a Tribunal has to stop at the first level of control, or can 'look through the corporate veil' of the controlling foreign national to determine whether there are further controlling companies of different nationality, and determine which one of them exercises 'effective' control. Past tribunals seem to have decided differently: in *Amco*[30], the tribunal stayed with the first-tier foreign shareholder, while in *SOABI*[31] the tribunal searched for real control and went one step further to second-tier control.[32]

In *Autopista Concesionada de Venezuela v. Venezuela* ("*Aucoven*"), *Aucoven* was controlled by the US corporation Icatech, which in turn was 100%-owned by the Mexican company ICA Holding. As Venezuela submitted, ICA Holding exercised direct control over its subsidiaries, including *Aucoven*. Venezuela thus argued that the 'effective' control thus lay with a Mexican company (not a Contracting State). The tribunal did not accept that Art. 25 (2) (b) required 'effective control', observing that the ICSID convention does not know such a requirement, and that it would be difficult and impractical to apply.[33] The tribunal then considered that the parties in their agreement had placed emphasis on the majority shareholding in *Aucoven*, and considered the majority shareholding to be a reasonable test for control[34] and within the limits imposed by the ICSID Convention.

The issue of "direct" or "effective control", albeit with regard to a respective BIT-clause, was also one of the main contentious issues in *Aguas del Tunari S.A.*

29 See *infra* the discussion of the cases *Autopista v. Venezuela and Aguas de Tunari v. Boliva*. This is irrespective of the fact that very often less than majority shareholding can be sufficient to control a corporation. Cf., *inter alia*, *International Thunderbird Gaming Corporation v. Mexico*, Award of 26 January 2006 (*van den Berg* (presiding), *Ariosa*, *Waelde*), para. 105-110.

30 *Amco v. Indonesia*, Decision on Jurisdiction of 25 September 1983, 1 ICSID Reports 396. The Tribunal held, however, that in exceptional circumstances it might search for the true controller of a company (*id.*, para. 14): "… in fact, it could be so where for political or economical reasons, it matters for the Contracting State to know the nationality of the controller or the controllers, and where it is proven that would the Contracting State have known this nationality, it would not have agreed to the arbitration clause; such a situation might possibly be met in exceptional instances".

31 *SOABI v. Senegal*, Decision on Jurisdiction of 1. August 1984, 2 ICSID Reports 182/3.

32 Cf. *Wisner/Gallus*, JWIT 2004, 927, 936 analyze these two decisions and argue that :"These facts suggest that investor-State tribunals will look through holding companies to determine control but will not look through companies pursuing activities in the jurisdiction in which they are incorporated."

33 *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, Case No. ARB/00/5, Decision on Jurisdiction of 27 September 2001 (*Böckstiegel, Cremades, Kaufmann-Kohler* (presiding)), para. 112-113.

34 *Id.*, para 117-121. Article 64 of the contract between the parties provided that if the majority of the shares should be sold to a national of a Contracting State of the ICSID Convention, then disputes should be settled at ICSID.

v.Republic of Boliva[35]. Aguas del Tunari S.A. ("*AdT*") is a Bolivian company the shares of which were owned – after some changes – by a chain of Dutch holding companies, the last one of which was held in equal parts by another subsidiary of the US company Bechtel Enterprise Holding, Inc ("Bechtel")and by the Italian company Edison S.p.A ("Edison") directly.

When a dispute arose, *AdT* brought a claim on the basis of the Netherlands-Bolivian BIT, Article 1 (b) (iii) of which provides that "nationals" of a Contracting Party (to the BIT) are also "legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the laws of the other Contracting Party". *AdT* thus claimed that it should be considered as a Dutch national, since it was controlled by Dutch companies. Bolivia objected to the jurisdiction of the Tribunal, arguing that *AdT* was not controlled by Dutch companies, but by Bechtel.

The Tribunal thus had to determine whether the indirect ownership of *AdT's* shares was sufficient, or whether the Dutch companies did not exercise control, as they in turn were owned by Bechtel and Edison. It noted that majority ownership of shares was generally considered to be sufficient for control and that it was nearly impossible to draw the line between formal control and 'actual control' required by Bolivia[36]. After a lengthy analysis of the holding structure and the provisions of the BIT, the Tribunal considered that majority ownership of shares was sufficient for 'control'[37] and that *AdT* was controlled by Dutch nationals.

3. Foreign Juridical Persons Controlled by Nationals of the Host State

No clear and uniform opinion, however, exists with regard to cases where the foreign juridical person, be it direct investor or only shareholder of the investor, is not owned and controlled by third-state nationals, but by nationals of the host state. To imagine such a situation might cause a certain kind of uneasiness, since the 'foreign' investor in fact would not be foreign at all. In his 2000 commentary on the ICSID Convention, Prof. *Schreuer* described this uneasiness as follows: "[I]f the immediate controller is a national of a Contracting State which is, in turn, controlled by nationals of non-Contracting States or even by nationals of the host state? Realism would militate against jurisdiction in such a case."[38]

The landmark decision in this respect seems to be the decision on jurisdiction in *Tokios Tokeles v. Ukraine*[39]. The dispute arose on the basis of the bilateral invest-

35 *Aguas del Tunari, S.A. v. Republic of Bolivia*, Case No. ARB /02/3, Decision on Respondent's Objections to Jurisdiction of 21 October 2005 (*Caron* (presiding)*, Alberro-Semerena, Alvarez*).

36 *Aguas de Tunari*, para. 246.

37 *Aguas de Tunari*, para. 264.

38 *Schreuer*, Art. 25 mn. 562.

39 *Tokios Tokeles v. Ukraine*, Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004 (*Weill* (presiding), *Bernardini*, *Price*).

ment treaty between Lithuania and Ukraine (the "BIT"). The Claimant, *Tokios Tokeles*, is a business enterprise established under the laws of Lithuania. It is owned and controlled by Ukrainian nationals, which hold ninety-nine percent of the company's outstanding shares. In 1994, *Tokios Tokeles* created *Taki spravy*, a wholly owned subsidiary established under the laws of Ukraine. *Tokios Tokeles* alleged that, beginning in February 2002, governmental authorities in Ukraine engaged in a series of actions with respect to *Taky spravy* that breached Ukraine's obligations under the BIT.

Ukraine argued that *Tokios Tokeles* should not be considered a 'genuine national' of Lithuania, since it was predominantly owned and controlled by Ukrainian nationals and also had no substantial business activities in Lithuania. To find jurisdiction, Ukraine argued, would be tantamount to allowing claims of nationals against their own governments and incompatible with the object and purpose of the ICSID convention.[40]

The Tribunal considered that under the BIT, the claimant's incorporation in Lithuania was sufficient to qualify it as an 'investor' of Lithuania. The Tribunal refused to apply a further 'control' or 'substantial business activity' test. It considered the lack of 'denial of benefits' provision to be a deliberate choice of Ukraine and Lithuania. Accordingly, *Tokios Tokeles* was held to be an 'investor' under the terms of the BIT.[41] The Tribunal then turned to Article 25 of the ICSID Convention.[42] Ukraine had asked the Tribunal to apply Article 25(2)(b) to create an exception to the state-of-incorporation rule of nationality. The Tribunal found no support in the text of the Convention for such an approach. It considered the object and purpose of Article 25(2)(b) to be expansion of jurisdiction, rather than limiting it.[43] The Tribunal also refused to apply the doctrine of "piercing the corporate veil". While it acknowledged that the doctrine formed part of customary international law, and that *Barcelona Traction*[44] was the seminal case affirming that proposition, it noted that Ukraine had not demonstrated that the requirements for veil-piercing had been met.[45] The Tribunal then found that its conclusions were consistent with earlier ICSID awards and the views of ICSID scholars.[46]

The chairman, Prof. Prosper *Weill*, dissented. He noted that "the approach taken by the Tribunal on the issue of principle raised in this case for the first time in ICSID's history is in my view at odds with the object and purpose of the ICSID Convention and might jeopardize the future of the institution."[47] Professor *Weill* criticized the majority's assumption that the origin of invested capital was not deci-

40 *Id.*, para. 22.
41 *Id.*, para. 38.
42 *Id.*, paras. 42-52.
43 *Id*., para. 46-49.
44 Case concerning the *Barcelona Traction, Light & Power Company, Ltd*. (note 9).
45 *Tokios Tokeles Award* (note 61), para. 53-56.
46 *Id.*, para 58-70.
47 Dissenting Opinion of *Professor Prosper Weil*, para. 1.

sive, denouncing this approach as "flying in the face of the object and purpose of the ICSID Convention and system". Relying *inter alia* on the preamble of the Convention and the Report of the Executive Directors on the Convention, he noted that the

"ICSID mechanism and remedy are not meant for investments made in a State by its own citizens with domestic capital through the channel of a foreign entity, whether pre-existent or created for that purpose."[48]

Quite the contrary decision seems to have been reached in the *Loewen*[49] case (an ICSID Additional Facility dispute). It is noteworthy that the Tribunal decided to pierce the corporate veil (although apparently denying that). After the Claimant had filed for bankruptcy in the US, all of its business operations were reorganized under the mantle of a United States corporation. The Canadian Loewen Group, immediately prior to its going out of business, assigned all of its right, title and interest to the NAFTA claim to a newly created corporation called Nafcanco. The tribunal considered that not Nafcanco, but the new US corporation should be considered as 'real' claimant

"By the terms of the assignment, the only item being assigned was this NAFTA claim. All of the assets and business of TLGI have been reorganized under the mantle of an American corporation. All of the benefits of any award would clearly inure to the American corporation. Such a naked entity as Nafcanco, even with its catchy name, cannot qualify as a continuing national for the purposes of this proceeding."[50]

4. Mail Box-Companies and Shells

Since 'control' is no requirement under the ICSID convention for the nationality of juridical persons (with the exception of Article 25 (2) (b)), it is in principle both possible and permissible[51] for an investor from a non-Contracting State to channel investments into a host country via the subsidiary in a third state which is a Contracting State. This may lead to disputes where the 'formal investor' is a mere mailbox company or 'shell' created for the purpose of achieving ICSID-jurisdiction[52].

48 *Id.*, para. 19.

49 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America.* Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*).

50 Id., para. 237.

51 *Aguas de Tunari*, para 330: "[…] it is not uncommon in practice, and - absent a particular limitation - not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT."

52 Although that seems unlikely. The primary driving factor for the structuring of a foreign investment is the existence of double taxation agreements. To prevent 'treaty shopping' in the field of double taxation agreements, many states, including Germany (§ 50d III EStG), have enacted 'denial of benefits'-provisions in their internal law which deny the advantages of a DTA to such mailbox companies. The scope of these provisions is similar to a denial of benefits-provision under a BIT.

The ICSID Convention does not contain explicit substantive requirements to prevent such a 'treaty shopping'-approach, but leaves it to the agreement of the parties to determine who is deemed to be a 'foreign national'. If the consent of the state is contained in a national law or a BIT, it is up to the contracting parties to include a respective "denial of benefits" provision. Several BIT's contain "denial of benefits"-provisions, pursuant to which the provisions of the Treaty are not applicable to companies controlled by third-state nationals (e.g. of states not party to that treaty), if those companies have no substantial business activity of their own. Respective arguments have been advanced, *inter alia*, by the state parties in *Generation Ukraine v. Ukraine* and in *Nova Plama A.D. v. Bulgaria*, but to no avail. In both cases, the tribunals considered that the requirements of the denial of benetifs-provision were not fulfilled.

Absent such a denial of benefits-provision, it seems that control by third-state nationals would not affect ICSID jurisdiction as long as the third state is a Contracting State to the ICSID convention.

It needs to be noted, however, that in several disputes the Contracting State parties have raised the objection that the Claimant was a mere shell which was created for the sole purpose of gaining access to ICSID jurisdiction. In each of these cases, the tribunals did not dismiss that objection *per se*, but were careful to show that the objection was unfounded on the facts.

In *Autopista v. Venezuela*, Venezuela had asserted that Icatech would be a corporation of convenience. The Tribunal analysed the context in which Icatech acquired shares in the claimant and considered that the assertion to be unfounded[53]. In *Tokios Tokeles v. Ukraine*, the tribunal did not in principle refuse to apply the doctrine of piercing the corporate veil, but merely considered that the requirements for doing so had not been fulfilled. In *Aguas de Tunari v. Bolivia*, Bolivia had asserted that the two Dutch companies were mere shells set up to obtain ICSID jurisdiction. The tribunal did not refuse that argument as being irrelevant *per se*, but concluded that both companies were not shells[54]. In its concluding observations, the tribunal also noted that it "does not find a sufficient basis in the present record to support an allegation of abuse of corporate form or fraud"[55]. It did not reject the respective allegation of Bolivia as irrelevant.

The reasoning of these cases does not indicate whether they considered the "shell-issue" to be part of the ICSID Convention or rather part of the respective bilateral investment treaty. Two recent non-ICSID awards, however, indicate that the shell-issue might be considered a part of the respective offer of the state party in a BIT to submit the dispute to arbitration.

53 *Autopista v. Venezuela*, paras. 123-126.
54 *Aguas de Tunari*, para. 320-323.
55 *Id.*, note 331.

In *X v. Kazakhstan*[56], an SCC case on the basis, *inter alia*, of the US-Kazakhstan bilateral investment treaty, the Tribunal was faced with Respondent's objection that the US corporate claimant was a mere shell controlled by non-U.S. nationals, possibly even Kazakh citizens. The Claimant had failed to produce documentation concerning its shareholders. The Tribunal noted that several provisions of the BIT related to ownership and control. It concluded that the Claimant was thus obliged to provide

"the necessary information and evidence concerning the circumstances of ownership and control, directly or indirectly, over [Claimant-investor] at all relevant times".[57]

Since the Claimant had not provided any evidence that U.S. citizens or companies had any degree of control over the Claimant, the Tribunal concluded that it had not been established that it had jurisdiction on the basis of the Treaty.

In Saluka Investments *BV v. Czech Republic*[58], the Tribunal came to a different conclusion. It was faced with the objection that the Claimant was a mere shell controlled by its UK parent company. The Tribunal observed that it had

" some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty."

However, it refused to find an implied "control"-requirement in the provisions of the Czech-Netherlands BIT.

"The Tribunal cannot in effect impose upon the parties a definition of "investor" other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands, and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add".[59]

While several tribunals seem to have accepted the argument that mail-box companies and shells set up for the mere purpose of obtaining access to arbitration should be denied that access, the jurisprudence is not yet uniform. However, none of the Tribunals seem to have interpreted an implied "control"-requirement into the ICSID-Convention. Also, both ICSID- and non-ICSID tribunals have pronounced on the shell-issue. That suggests that if an implied control-requirement exists, it must be found in the state's offer to arbitrate contained in the respective BIT.

56 Jurisdictional Award rendered in 2003 in SCC Case 122/2001, Stockholm International Arbitration Review 2005:1, 123.

57 *Id.*, 151-152.

58 *Saluka Investment BV v. Czech Republic*, Partial Award of 17 March 2006 (*Sir Arthur Watts* (presiding), *Fortier, Behrens*).

59 *Id.*, paras. 240-241.

C. Exhaustion of Local Remedies

I. Exhaustion of Local Remedies in International Law

The exhaustion of local remedies rule is a rule of customary international law. In the *Interhandel* Case, the International Court of Justice stated that:
"The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law; the rule has been generally observed in cases in which a State has adopted the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law. Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic system."[60]

In the *ELSI*-case, the International Court of Justice acknowledged that the local remedies rule may be derogated from, qualified or varied by any binding treaty. However, the Court pointed out that the
"[…] Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an objection to do so."

In this report, it shall be assumed that this rule has a procedural nature only. There has been a long standing debate whether the rule forms a part of procedural law or whether it is a substantive requirement for a breach of international law to exist. It is neither appropriate nor possible to give even a summary of this debate, or to comment on it. Instead, reference shall be made to the summary given by *John Dugard*, Special Rapporteur of the International Law Commission, in his second report on diplomatic protection[61].

However, both the procedural and the substantive aspects of the rule of exhaustion of local remedies have been discussed in recent cases. Consequently, both shall be reviewed.

II. Exhaustion of Local Remedies as a Procedural Requirement

Art. 26 ICSID Convention reads as follows:
"Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."

60 1959 ICJ Reports 27.
61 *Dugard*, Second report on diplomatic protection, ILC 53rd session, UN Doc. A/CN.4/514, pp. 15-32.

Absent an explicit requirement to the contrary – in bilateral investment treaties, national legislation or investment agreements – access to ICSID thus will not require the exhaustion of local remedies. This serves to further the Centre's purpose as a neutral venue for the settlement of investment disputes[62], and also the exclusive character already provided for in the first sentence.

In *Generation Ukraine v. Ukraine*, the Respondent thus fruitlessly argued that the Claimant first had to exhaust local remedies before resorting to ICSID Arbitration. The dispute arose on the basis of the US-Ukrainian bilateral investment treaty (the "BIT"), which did not contain a respective requirement of exhaustion of local remedies. Since Ukraine had given its consent to ICSID arbitration already in the BIT, which was matched by the investor's consent (given by filing the notice of arbitration), the Tribunal considered the reliance on Article 26 ICSID convention to be unfounded[63].

The duty to exhaust local remedies refers only to *legal* remedies. It is considered that this includes judicial remedies before ordinary and extraordinary courts as well as available remedies before administrative bodies. However, the individual is not obliged to exhaust "extra-legal remedies or remedies as of grace" or remedies which are of a discretionary nature[64].

It is considered that local remedies need not be exhausted where they provide no reasonable possibility of an effective remedy[65]. In The *Loewen Group, Inc. and Raymond R. Loewen v. United States of America*[66], the Tribunal put it as follows (para. 168 *et seq*.):

"It is an obligation to exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which he is situated.

169. Availability is not a standard to be determined or applied in the abstract. It means reasonably available to the complainant in the light of its situation, including its financial and economic circumstances as a foreign investor, as they are affected by any conditions relating to the exercise of any local remedy.

170. If a State attaches conditions to a right of appeal which render exercise of the right impractical, the exercise of the right is neither available nor effective nor adequate. Likewise, if a State burdens the exercise of the right directly or indirectly so as to expose the complainant to severe financial consequences, it may well be that the State has by its own actions disabled the complainant from affording the State the opportunity of redressing the matter of complaint. The scope of the need to exhaust local remedies must be considered in the light of these considerations."

62 Cf. *Schreuer*, Preamble Mn. 16-21.

63 *Generation Ukraine, Inc. v. Ukraine*, Case No. ARB/00/9, Award of 16 September 2003 (*Salpius, Voss, Paulsson* (presiding)), paras. 13.1 – 13.6.

64 *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 8; *Brownlie*, Principles of Public International Law, 5th ed., p. 499.

65 *Dugard*, Third report on diplomatic protection, UN Doc. A/CN.4/523, p. 17

66 *Loewen Group, Inc. and Raymond R. Loewen v. United States of America.* Case No. ARB /AF)/98/3, Award of 26 June 2003 (*Mason, Mikva, Mustill*), para. 169.

It must be mentioned, however, that the decision then rendered by the *Loewen* Tribunal is not free from criticism[67]. The Tribunal considered that the claimants had not exhausted all available remedies (but settled instead), although an appeal vas virtually impossible and chances for further remedies (such as a Supreme Court review), were considered by experts as exceedingly remote.

Several BIT's contain requirements that the investor must first turn to the local courts and can only after a certain time of pending proceedings initiate arbitration. The purpose of such a rule seems to be similar to the purpose of the rule of exhaustion of local remedies: to give the Respondent state the possibility to redress the wrong done by its own legal system[68]. However, such a rule is, technically speaking, not a requirement of exhaustion of local remedies. Thus, in *Maffezini v. Spain,* in *Siemens v. Argentina* and in *Gas Natural v. Argentina*, the tribunals considered such a rule not to require the exhaustion of local remedies[69].

III. Exhaustion of Local Remedies as a Substantive Requirement for a Breach

As discussed above, the substantive aspect of the exhaustion of local remedies rule is not a procedural requirement, but pertains to the question whether there has been a breach of international law at all. Reviewing recent awards, three different aspects can be differentiated.

1. Denial of Justice

It is generally accepted that a denial of justice requires that the individual has exhausted all reasonable local remedies[70]. The landmark case in this regard is *Loewen v. United States*. The claimants had lost a jury trial in Mississippi and were faced with a judgement over US-$ 500 million. While the tribunal concluded that the court failed to "afford Loewen the process that was due", it also considered "that a court

67 Cf. *Paulsson*, Denial of Justice p. 122-125; *Rubins*, *Loewen v. United States*: The Burial of an Investor-State Arbitration Claim, Arbitration International 21 (2005), p. 1 *et seq*.

68 Cf. *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 2.

69 *Emilio Agustín Meffezini v. The Kingdom of Spain*, Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (*Orrego Vicuna* (presiding), *Burgenthal*, *Wolf*), para. 28*; Siemens A.G. v. The Argentine Republic*, Case No. ARB/02/8, Decision on Jurisdiction of 3 August 2004 (*Rigo Sureda* (presiding), *Brower*, *Bello Janeiro*), para. 104*; Gas Natural SDG, S.A. v. The Argentine Republic*, Case No. ARB/03/10; Decision of the Tribunal of 17 June 2005 on Preliminary Questions on Jurisdiction (*Lowenfeld* (presiding), *Lavarez*, *Nikken*), para. 30.

70 *Paulsson*, Denial of Justice, p. 108.

decision which can be challenged through the judicial process does not amount to a denial of justice at the international level"[71]. It noted that the

"purpose of the requirement that a decision of a lower court be challenged through the judicial process before the State is responsible for a breach of international law constituted by judicial decision is to afford the State the opportunity of redressing through its legal system the inchoate breach of international law occasioned by the lower court decision. The requirement has application to breaches of Articles 1102 and 1110 as well as Article 1105."

It is noteworthy that this purpose is the same which is thought to be the purpose of the procedural rule of exhaustion of local remedies[72].

2. No Breach of International Law by a Decision of a Lower Court?

The *Loewen*-award suggests that the acts of a court of first instance do not normally give rise to the level of an international wrong[73]. For the *Loewen*-Tribunal considered that the requirement of exhaustion of remedies against the decision of the lower court applied not only in cases of denial of justice, but also to alleged breaches of Article 1105 NAFTA (fair and equitable treatment) and Article 1110 NAFTA (expropriation).

It needs to be recalled that each and every court, and not the court system in itself, is an 'organ' of the state, the acts of which can be attributed to the state[74]. A state is responsible for actions of its courts which are in breach of international law[75]. Second, irrespective of the attribution of an act to the state, state responsibility further requires that the act is in breach of international law. Whether a judgement of a lower court, against which an appeal is possible, constitutes a breach of an international obligation, can only be determined with respect to that particular obligation. With regard to a denial of justice, the conduct of a court of first instance does not constitute a breach since, as *Paulsson* describes it, "[t]he obligation is to establish and maintain a system which does not deny justice; the system is the whole pyramid."[76]

71 *Loewen*, para. 153.

72 Cf. *Dugard*, Second report on diplomatic protection, UN Doc. A/CN.4/514, p. 2 (citing *Borchard* and *Jiménez de Aréchaga*).

73 *Rubins*, Arbitration International 21 (2005), p. 16.

74 *Cf.* draft Article 4 (1) of the ILC draft Articles on State Responsibility (underlining by author): "The conduct of *any* State organ shall be considered an act of that State under international law, whether that organ exercises legislative, executive judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State."

75 *Paulsson*, Denial of Justice, p. 84-87.

76 *Paulsson*, Denial of Justice, p. 109.

The *Loewen*-holding seems to extend the reach of the 'substantive exhaustion of local remedies' from denial of justice to expropriation and fair and equitable treatment. Whether that holding accurately reflects the state of the law under NAFTA, or general customary international law, deserves further analysis.

3. No Breach of International Law if Local Remedies are Available?

Several awards indicate that certain forms of state conduct might not constitute a breach of an obligation under a BIT as long as local remedies are available to the investor.

In *Feldman v. Mexico*[77], the arbitral tribunal found that although "the Claimant, through the Respondent's actions, is no longer able to engage in his business" as a result of the elimination of a tax rebate on export resales of cigarettes"[78], and although "it is undeniable that the Claimant has experienced great difficulties in dealing with [Ministry] officials, and in some respects has been treated in a less than reasonable manner",[79] the Mexican Government's regulatory actions were, on balance, not equivalent to an expropriation. In declining to find that the claimant's allegations of unlawful administrative actions constituted expropriation, the tribunal took account of the availability of court review of those administrative actions[80].

In *Generation Ukraine v. Ukraine*[81], the claimant alleged that through a series of actions and omissions, the Ukrainian authorities had expropriated his investment in an office building. The tribunal found that due to the lack of seeking local remedies, no expropriation took place:

"20.30 The fact that an investment has become worthless obviously does not mean that there was an act of expropriation; investment always entails risk. Nor is it sufficient for the disappointed investor to point to some governmental initiative, or inaction, which might have contributed to his ill fortune. Yet again, it is not enough for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated virtual expropriation. In such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, not because there is a requirement of *exhaustion* of local remedies but because the very reality of conduct

77 *Marvin Feldman Karpa v. Mexico*, Case No. ARB(AF)/99/1, Award of 16 December 2002 (*Kerameus* (presiding), *Bravo*, *Gantz*).

78 *Id.*, para. 109.

79 *Id.*, para. 113.

80 *Id.*, para. 140.

81 *Generation Ukraine, Inc. v. Ukraine*, Case No. ARB/00/9, Award of 16 September 2003 (*Salpius, Voss, Paulsson* (presiding)).

tantamount to expropriation is doubtful in the absence of a *reasonable* - not necessarily exhaustive - effort by the investor to obtain correction."

In *Waste Management v. Mexico (II)*[82], the tribunal concluded that the alleged breach of a contractual obligation by a state did not constitute a breach NAFTA Article 1105 (fair and equitable treatment)

"116. […] It is true that in a general sense the exhaustion of local remedies is a procedural prerequisite for the bringing of an international claim, one which is dispensed with by NAFTA Chapter 11. But the availability of local remedies to an investor faced with contractual breaches is nonetheless relevant to the question whether a standard such as Article 1105(1) have been complied with by the State. Were it not so, Chapter 11 would become a mechanism of equal resort for debt collection and analogous purposes in respect of all public (including municipal) contracts, which does not seem to be its purpose."

or Article 1110 (expropriation):

"175. The Tribunal concludes that it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the present case the Claimant did not lose its contractual rights, which it was free to pursue before the contractually chosen forum. The law of breach of contract is not secreted in the interstices of Article 1110 of NAFTA. Rather it is necessary to show an effective repudiation of the right, unredressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent."

Other tribunals have reached similar conclusions with regard to contract breaches[83].

The latest decision in this regard is the (non-ICSID) award in *EnCana v. Ecuador*, in which the refusal of a governmental agency to grant tax refunds was at issue. The claimant alleged that the state had expropriated its right to the refunds. The tribunal, relying on the *Waste Management* – award, held that

"In terms of the BIT the executive is entitled to take a position in relation to claims put forward by individuals, even if that position may turn out to be wrong in law, provided it does so in good faith and stands ready to defend its position before the courts. Like private parties, governments do not repudiate obligations merely by contesting their existence. An executive agency does not expropriate the value represented by a statutory obligation to make a payment or refund by mere refusal to pay, provided at least that (a) the refusal is not merely wilful, (b) the courts are open

82 *Waste Management, Inc v. United Mexican States*, Case No. ARB (AF)/00/3, Award of 30 April 2004 (*Crawford, Civiletti, Gómez*), paras. 161-174.

83 *SGS v. Philippines*, Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004 (*El-Kosheri, Crawford, Crivellaro*), para. 163; *Consortium RFCC v. Royaume du Maroc*, Case No. ARB/00/6, Award of 22 December 2003 (*Briner, Cremades, Fadlallah*), Abs. 65: "Pour qu'il y ait droit à compensation if faut que la personne de l'exproprié prouve qu'il a été l'objet de mesures prises par l'Etat agissant non comme cocontractant mais comme autorité publique".

to the aggrieved private party, (c) the courts' decisions are not themselves overridden or repudiated by the State."[84]

D. Summary and Concluding Remarks

Parties are free to include into their arbitration agreements provisions on nationality. In treaty-based investment arbitration, the agreement of the parties is constituted by the dispute settlement offer of the BIT, which is accepted by the investor. State parties have the possibility to include denial of benefits-clauses into the BIT and, by this, to exclude certain groups of investors from the scope of their offer to arbitrate.

The reviewed cases suggests that in determining the nationality of corporations, ICSID Tribunals give deference to any existing agreements of the parties. As long as a tribunal considers an agreement not be incompatible with explicit provisions or with the object and purpose of the ICSID Convention, it will uphold that agreement.

In those cases where nationality was disputed (e.g. *Tokios Tokeles*), the problems arose from the lack of such provisions. Since the ICSID Convention sets only the outer limits for such agreements, it should not be burdened with issues which the parties could and should have regulated for themselves (such as excluding investors which are controlled by host-state nationals). Irrespective of that, several awards indicate that tribunals will not accept mere shells as Claimants. While their reasoning is not entirely consistent, it seems that tribunals interpret into the dispute set-

84 *EnCana Corporation v. The Republic of Ecuador*, LCIA Case No. UN3481, Award of 3 February 2006 (*Crawford* (presiding), *Grigera Naon*, *Thomas*), para. 194. The award was rendered by a majority only. Arbitrator *Horacio Grigera-Naon* dissented sharply: "To require such "substantive" exhaustion of local remedies, consisting of a prior and final determination by the local courts of the host State under its own national law of disputes concerning the entitlement of rights (or denial of such rights) of a foreign investor covered by the Treaty, suggests the existence of a public international law had-and-fast rule, binding on international arbitral tribunals, according to which such rights are localized in the host State, exclusively governed by its own laws and, for that reason, that disputes involving such rights must be previously adjudicated by the courts of the host state under its own laws, before related claims under international law are ripe for decision on the merits at the international level."

tlement offer of a bilateral investment treaty a respective implied prohibition of shell companies as claimants.

The rule of exhaustion of local remedies has little practical relevance as a procedural rule in treaty-based investment arbitration. However, Tribunals have declined to find a breach of BIT-provisions where the investor alleged the non-fulfilment of rights existing under the law of the host state, but failed to seek recourse with (not necessarily exhaust) available local remedies. Investors wishing to submit such a dispute to treaty-based arbitration should thus carefully review whether the respective dispute settlement clause allows for such disputes, or is limited to disputes relating to a breach of the BIT.

The "Foreign Nationality"-Requirement and the "Exhaustion of Local Remedies" in Recent ICSID Jurisprudence

Comment by *Michael Kerling*[*]

A. Introduction

I have been asked to comment on the report "The foreign nationality requirement and the exhaustion of local remedies in recent ICSID Jurisprudence" by Dr. *Richard Happ*. As an in-house counsel of a major German construction contractor my comments will be focused on the rather practical aspects of ICSID and I will mainly concentrate on the experiences of our company within the last four years.

As far as I am informed, our company is still the only German construction company that has ever been involved in ICSID proceedings even though it seems to have been established by recent ICSID Jurisprudence that as a matter of principle a construction project in a foreign state might be considered an investment in the sense of bi- or multilateral investment treaties.

Even though we have considered international arbitration on the basis of bilateral investment treaties in the context of quite a few projects, only two cases have "really made it to Washington" so far. One of these cases is the quite well known case "*Impregilo vs. Pakistan*" – our company has been one of the partners of the respective joint venture. The other case "*Ed. Züblin AG vs. Kingdom of Saudi Arabia*" is for sure less known, mainly because it has been finished through amicable settlement in a very early stage.

B. The "Foreign Nationality"-Requirement and "Treaty Shopping" in Practice: Impregilo vs. Pakistan

The case "*Impregilo vs. Pakistan*" seems at least in parts to be suitable for some further thoughts about the "foreign nationality requirement" already discussed in more detail by my colleague Dr. *Happ.*

As I mentioned earlier, our company has been one of the members of an unincorporated joint venture under Swiss law lead by the Italian contractor *Impregilo*, consisting of *Impregilo*, German *Ed. Züblin AG* and two Pakistani contractors. The dispute arose out of two contracts relating to the construction of hydro-electric power facilities located on the Indus river immediately downstream of the Tarbela

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Dam in Northern Pakistan, that when completed, would increase power generation in Pakistan by 15%.

The joint venture had suffered immense damages through continuous frustration of the contractual dispute resolution instruments (Dispute Adjudication Boards in the sense of the FIDIC Red Book). The frustration went far beyond what might have to be expected in such environment. The Employer, the Pakistan Water and Power Development Authority, not only continuously refused any cooperation with regard to obviously outstanding claims but also acted to the detriment of the joint venture by nominating obviously biased adjudicators and by continuously questioning the credibility of the adjudicators nominated by the joint venture. Thus, a fruitful and reasonable handling of the claims became impossible. On the top of that the situation for a foreign contractor became increasingly difficult due to the consequences of the terrorist attacks of 11th September 2001.

All this lead us to the decision to search for a solution on the international level. Unfortunately, we had to notice that there was no BIT providing for an ICSID clause between the Islamic Republic of Pakistan and the Federal Republic of Germany (the old BIT between Germany and Pakistan, which was signed in 1959, does not contain such a clause and has never been amended accordingly). However, a BIT with an ICSID clause was signed between Italy and Pakistan on 19th July 1997. The joint venture decided to start proceedings on this basis. Of course the joint venture was aware of the jurisdictional problems that this might cause but due to the lack of alternative there was no choice but trying it.

As expected, the jurisdiction "*ratione personae*" was one of the main points challenged by the Islamic Republic of Pakistan ("the Respondent"). The Respondent argued that the Italian Contractor could not pursue claims on behalf of the joint venture because the joint venture lacked legal personality and therefore could not be considered as an entity of foreign nationality in the sense of the ICSID Convention. All partners to the joint venture would rather have to appear on their own behalves. The main counter arguments of the joint venture was the following:

The Italian contractor had to have a possibility to assert the claims on behalf of the joint venture as leader and majority stakeholder in the joint venture for the following reasons: Under the joint venture agreement, the Italian contractor was obligated to distribute any monetary judgement awarded to it in an arbitral proceeding to its joint venture partners according to the respective stakes of the partners in the joint venture. Thus, the only way for the Italian Contractor to obtain its full share in the joint venture would have been for the Tribunal to permit the Italian Contractor to proceed on behalf of the joint venture. Otherwise, the aim of the BIT, which always must be the full protection of the foreign investor, could not be reached.

Unfortunately in its decision on jurisdiction, the Tribunal did not follow this view and considered that the Italian Contractor was not able to pursue claims on behalf of the joint venture. It mainly referred to Article 25(2)(b) of the Convention, which defines as we have heard before, that the investor, who may be either an individual or a juridical person, must not have the nationality of the Contracting State which is a party to the dispute. Referring to the drafting history of the Convention the Tribu-

nal then concludes that an association of individuals or juridical persons does not qualify as a foreign juridical person for the purposes of the Convention. This lead to the conclusion of the Tribunal that the joint venture as a whole was not covered by the BIT.

In the Tribunals view, the Italian Contractor was not able to claim compensation amounting to 100% of the damages suffered by the joint venture: In its view, of the three other joint venture partners 1.) none was a protected investor in the terms of the BIT, (2.) two were not nationals "of another Contracting State" for the purposes of Art. 25(1) of the ICSID Convention. It pointed out that in concluding the BIT with Italy, the Respondent had conferred certain rights exclusively to Italian nationals but not to any other nationals; not to mention Pakistani investors themselves.

The fact that the Italian investor was forced by the joint venture agreement to distribute any awarded sums to the other partners to the joint venture was considered a mere internal contractual problem of the Italian Contractor. It has to be mentioned that the Tribunal declined this argument in only a few words, which we considered as neither convincing let alone satisfying. However, the view of the Tribunal seems to be in line with former ICSID jurisprudence.

Nevertheless, the case, containing some further interesting questions, could be settled shortly after the decision on jurisdiction had been released. At least a part of the damages suffered was compensated, which would most probably not have been the case if the joint venture had not decided to bring the case to international arbitration.

From the point of view of "Treaty Shopping", which was also raised by my colleague Dr. *Happ*, our company drew the conclusion that it might be wise not only to clarify whether a BIT containing an ICSID clause exists before negotiating contracts with public entities abroad but also to choose foreign partners against the background of a possibly existing BIT. Even though it has been established in the above mentioned decision that in a joint venture only partners being nationals of one of the contracting states can claim jurisdiction, it still is a means of pressure to have at least one partner in a joint venture who is able to refer the dispute to ICSID arbitration if any other instrument of reasonable dispute resolution has failed.

C. The "Exhaustion of Local Remedies": Ed. Züblin AG vs. Kingdom of Saudi Arabia

As I mentioned earlier, this case has been settled in such an early stage that probably none of you has even heard of it. I am not sure if I really fully hit the mark of the topic but when drafting our request for arbitration we came at least across some very interesting questions concerning local remedies.

The dispute arose out of the long delay in the rendering of a judgement by the courts of the Kingdom of Saudi Arabia as well as the persistent failure by the Government of the Kingdom of Saudi Arabia to honour a final and binding judgment in favour of our company.

A few words concerning the project and the dispute: On 8th April 1978, King Saud University ("the University") and our company entered into a contract to construct a new academic campus for the University. This contract was substantially completed in May 1986. Continuous failures to comply with its obligations under the contract by the University caused the Contractor to suffer significant damages. Any claims always submitted in accordance with the contract were rejected by the University. The Contractor therefore was compelled to submit these claims to the "Board of Grievances", which was according to the contract to resolve any disputes between the parties. The lawsuit was initiated in 1984. On 12th March 2001, a judgment awarding the contractor more or less what was claimed 17 years before. Our lawyers in Saudi Arabia considered this judgment "most probably final". What had happened during this period of 17 years? In the following a short overview from the time of submitting the points of claim until the issuance of a "final judgment":

- 24th March 1986: first hearing
- no communication and no explanation in the following 6 years
- 3rd March 1992: re-opening of the case due to appointment of new judges
- "final hearings" on 2nd May and 19th October 1992
- no action in the following three years
- re-opening of the case on 14th February 1995
- 19th December 1995: first judgment
- appeal of the University, relegation to Board of Grievances
- 29th September 1997: appointment of a Technical Expert
- 25th January 1999: submission of the report, confirming first judgment
- accusation of the Technical Expert of bribery and forgery by the University
- 5th July 2000: rejection of the accusations by the Investigation Bureau
- 8th October 2000: new judgment ordering the University to pay the claimed amount
- appeal by the University
- 12th March 2001: confirmation of judgment of 8th October.

After the last confirmation of the judgment nobody could really assure us that it was really final. Our company made multiple attempts to obtain the sums awarded but all such attempts failed: All governmental bodies involved had been informed, the request was sent from one authority to the other, but none of the officials involved wanted to make any statement. Our company even referred the dispute to the Royal Court (but this obviously is not a further instance in Saudi judicial system) and to the Saudi General Investment Authority, which was founded in the year 2000 in connection with the new Foreign Investment Law in order to improve the "investment climate" in the Kingdom of Saudi Arabia. Additionally, the German Embassy officially but unsuccessfully raised the issue several times with the Government of Saudi Arabia. Yet, because none of these attempts led to any success and due to the lack of enforcement rules against public entities in the Saudi legal system, we started thinking about ICSID and decided to initiate respective proceedings

against the Kingdom of Saudi Arabia on the basis of the BIT signed between Germany and Saudi Arabia on 29th October 1996.

In the light of such history, the term of "exhaustion of local remedies" became quite of essence for us. It is difficult to establish such exhaustion if it is completely unclear how the local remedies work. For that reason, we had to do some in-depth research on the Saudi judicial system when drafting our request for arbitration and we learnt that the Saudi legal system belonged to the legal systems where it might even be impossible to establish the requirement of exhaustion of local remedies.

There are only very few publications on the Saudi legal system so that we had to rely mostly on information of our local counsels. The Board of Grievances, before which our case was handled, is a very traditional institution dating from the early years of Islam. It was revived by the Saudis in the fifties and today has amongst others exclusive jurisdiction over "cases regarding disputes relative to contracts to which the Government or public juridical person is a party". Judgments usually are not published and the stages of appeal are extremely complicated and thus confusing. Especially in the procedure for disputes between private companies and public entities, there are different stages of "automatic appeal" and endless relegations, which are quite difficult to follow. By all means, in the end, we just had to assume that the local remedies had been exhausted in this case and submitted our request for arbitration on this basis.

Fortunately for us but unfortunately for those dedicated to ICISD jurisprudence a very profitable settlement offer came shortly after the Tribunal had been constituted. This way, many interesting questions have never been dealt with. Another question in this case would also have been the one of the foreign joint venture partner because our company had been the leader of a joint venture with two Swiss partners.

D. Conclusion

Both of our cases show that ICSID arbitration has proven as a successful instrument of pressure for companies involved in multinational projects, when conventional mechanisms of dispute resolution or enforcement of judgements fail. Therefore, from the point of view of an international contractor, it definitely makes sense to verify whether a Bilateral Investment Treaty containing an ICSID clause exists before entering into a contract with a foreign public entity.

The "Foreign Nationality"-Requirements in ICSID Arbitration

Comment by *Anthony C. Sinclair**

This commentary to Dr *Happ*'s paper[1] focuses on the first of his two topics and deals with three essential themes. First, this commentary acknowledges the relationship between the element of consent called for pursuant to Article 25 of the 1965 „Convention on the Settlement of Investment Disputes between States and Nationals of other States" (the "Convention"[2]) and the nationality requirements of any applicable investment protection treaty. Secondly, it emphasises the mandatory requirements of the Convention as to nationality for the „International Centre for the Settlement of Investment Disputes" ("ICSID" or "the Centre") to have jurisdiction and highlights their interplay with requirements to qualify for investment treaty protection. And finally, the commentary conducts a brief and admittedly selective survey of the diversity of approaches to nationality and qualification for protection found in investment treaties, and how these approaches can interact with the objective outer limits of ICSID jurisdiction.

Possession of the nationality of a Contracting State to the Convention is a door through which an investor must pass in order to be able to bring a claim within ICSID's jurisdiction. Article 25(1) of the Convention provides that the jurisdiction of the Centre:

"shall extend to any legal dispute arising directly out of an investment between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally" (emphasis added).

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1 *Happ*, "The Foreign Nationality Requirement and the Exhaustion of Local Remedies in Recent ICSID Jurisprudence", The International Convention for the Settlement of Investment Disputes: Taking Stock after 40 Years, Frankfurt, 26 to 28 April 2006.

2 World Bank Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington D.C. 1965 signed 18 March 1965, in force 14 October 1966, 575 U.N.T.S. 159 reprinted in (1965) 4 I.L.M. 532 and available online at www.worldbank.org/icsid.

Dr *Happ* rightly acknowledges that in practice it is the scope of "consent" that is the key for claimants' standing. For in the vast majority of ICSID cases today, arbitration proceedings stem from a standing generic offer on the part of the host State to arbitrate disputes with qualified foreign investors set out in an investment promotion and protection treaty. Having the nationality of an investor to whom such an offer is made is therefore an essential element in order for the parties' consent to arbitrate disputes to crystallise. Matters of ICSID case law necessarily merge here with questions of qualification arising under investment protection treaties, notwithstanding that strictly speaking it is only the former that is the topic of this conference. It is for this reason, however, that reference may be made to questions of nationality arising both under investment treaties as well as under the Convention. Indeed, many of the most interesting nationality cases of recent years concern nationality for the purpose of ascertaining consent under the applicable BIT, not simply nationality for the purposes of Article 25 of the Convention.

These instruments – the Convention and any applicable investment treaty – present dual requirements for the Centre to have jurisdiction to decide a dispute. A claimant must establish *both* that it meets the nationality conditions in any treaty, as well as the objective requirements of the Convention. The relationship between these is governed by Article 25, which sets the "outer limits" of ICSID's jurisdiction.[3] The majority in *Tokios Tokelės* v. *Ukraine* therefore may well have incorrectly marginalised the requirements of the Convention - express or implied - when it essentially deemed its jurisdiction to be established merely by satisfaction of the criteria for standing under the applicable Lithuania-Ukraine BIT.[4] There is principle behind the majority's approach which many will favour: generally, "an agreement to submit to ICSID's jurisdiction should be upheld unless it would lead to a use of the Convention for purposes for which it was clearly not intended".[5] It is precisely that cautionary proviso, however, that motivated the chairman of the Tribunal to disagree with the majority. *Weil*'s frequently cited dissent – perhaps even more so than the majority decision itself – takes the view that satisfaction of the nationality conditions for jurisdiction to exist under the Convention must be "the first leg of the reasoning".[6] *Weil* opined that although the Contracting Parties to an investment treaty "are free to confer to the ICSID tribunal a jurisdiction narrower than that provided for by the Convention, it is not for them to extend the jurisdiction of the ICSID tribunal beyond its determination in the Convention".[7]

The divergence between the arbitrators in *Tokios* turned on the recurring – and yet to be convincingly resolved – question whether ICSID jurisdiction can extend to a

3 *Broches*, The Convention on the Settlement of Investment Disputes between States and Nationals of other States, (1972-II) 136 Recueil des Cours 331, 361 (hereafter "*Broches*").
4 Decision on Jurisdiction dated 29 April 2004.
5 *Schreuer*, The ICSID Convention: A Commentary (2001), Article 25, para. 464 (hereafter *"Schreuer*").
6 Dissenting Opinion dated 29 April 2004, para. 15.
7 *Tokios*, Dissenting Opinion of Prosper *Weil*, para. 13.

juridical entity incorporated in another Contracting State to the Convention that is owned or controlled by nationals of the host State. As Dr *Happ* has described, the majority in *Tokios* saw no impediment to their jurisdiction in these circumstances once the criteria in the investment treaty were found to be satisfied. Notably, during the drafting of the Convention, a proposal was raised to define standing by reference to the foreign origin of the investment, consistent with the Convention's goal to encourage the international flow of capital. The idea was not pursued[8] and, indeed, in many ICSID cases the fact that funds have been sourced locally has not proved an impediment to ICSID jurisdiction.[9] Although the national origin of capital *per se* may therefore not be relevant to ICSID jurisdiction, the national origin of the controllers of the investment may well be. *Weil* would have declined jurisdiction in the light of the general principle in international law that a national is not permitted to sue its own State in an international forum[10] and the fact that the Convention is concerned with "the need for *international cooperation* for economic development and the role of private investment therein", not the resolution of essentially domestic disputes.[11] Foreshadowing this issue in his Commentary, *Schreuer* admitted to finding the possibility that a national of a host State may seize ICSID of jurisdiction via a corporate vehicle incorporated in another Contracting State "troubling".[12] He believed that "realism" ought to "militate against jurisdiction" where the claimant company is controlled by nationals of the host State:

"[o]n balance, the better approach would appear to be a realistic look at the true controllers thereby blocking access to the Centre for juridical persons that are controlled directly or indirectly by nationals of non-Contracting States or nationals of the host State".[13]

The majority decision in *Tokios* turned on the presumed intention of the Contracting Parties to the Lithuania-Ukraine BIT. The majority's reasoning is relatively less concerned with the objective requirements for jurisdiction to exist under the ICSID Convention. Like *Tokios*, it is also conspicuous that the jurisdictional decision in *Aguas del Tunari S.A.* v. *Republic of Bolivia* contains no explicit discussion as to whether the objective requirements of the ICSID Convention were met in that case, although there is again extensive reference to the requirements of the applicable investment treaty.[14] The Tribunal's decision contains a lengthy treatment of the requirements for an entity to qualify for protection under the Bolivia-Netherlands BIT but no reference to ICSID Article 25(2)(b) even though the claimant was Bo-

8 *Schreuer*, Article 25, para. 427.

9 *E.g.*, *Tradex Hellas S.A.* v. *Republic of Albania*, Award dated 29 April 1999, para. 109.

10 *Ibid*., paras. 5, 10; also *Schreuer*, Article 25, para. 496: "The Convention is designed to facilitate the settlement of investment disputes between States and nationals of other States. It is not meant for disputes between States and their own nationals. The latter type of dispute is to be settled by domestic procedures, notably before domestic courts".

11 Convention, Preamble, para. 1 (emphasis added).

12 *Schreuer*, Article 25, para. 562.

13 *Ibid*., para. 563.

14 Decision on Jurisdiction dated 21 October 2005.

livian.[15] Charitably perhaps, the Tribunal was content *to infer* the exi-stence of an agreement between the parties to treat the Bolivian company, *Aguas del Tunari*, as a national of a foreign Contracting State *because of* foreign control once it had established that it fell within the definition of a Dutch "investor" as set out in the BIT. Admittedly, the Convention requires no special form for such an agreement.[16] *Schreuer* observes, in fact, that "[t]he practice of ICSID tribunals shows an increasing readiness to accept an implicit agreement to treat a juridical person as a foreign national because of foreign control".[17] From that practice, *Schreuer* deduces that "[i]f the investor takes up the offer contained in the … treaty, the provisions on access of locally established but foreign controlled companies become part of the agreement between the parties".[18] This approach is consistent with the universally-accepted construction of an agreement to arbitrate arising from the offer on the part of host States found in modern investment treaties, and the acceptance of that offer by investors at the time they submit a request for arbitration.[19] It also appears to be the approach adopted by the Tribunal in *Aguas del Tunari*. The case is a relatively rare modern example of a question of ICSID jurisdiction potentially turning on the application of Article 25(2)(b). As investment protection treaties are repeatedly confirmed to confer upon the foreign shareholders in local companies both substantive protection and a direct right to submit claims to arbitration for harm suffered to their subsidiaries,[20] recourse to ICSID's jurisdiction for a locally-incorporated entity ceases to depend on the existence of an agreement to treat it as a foreign national.[21] It is therefore unfortunate, for those seeking further clarification of ICSID law, at

15 With respect to legal persons, a national of a Contracting State is defined in Article 25(2) as: "(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention".

16 *Schreuer*, Article 25, para. 504.

17 *Ibid*., para. 510.

18 In this manner, an express agreement is formed: *ibid*., para. 505, also 536 but *cf*. para. 519 where *Schreuer* doubts whether an *implied* agreement on nationality can arise where consent to jurisdiction is based on the host State's legislation or on a treaty: "If the investor simply accepts a standing offer by the host State to submit to jurisdiction, no agreement to treat that particular investor as a foreign national can be imputed to the host State".

19 *E.g.*, *El Paso Energy International Company* v. *The Argentine Republic*, Decision on Jurisdiction dated 27 April 2006, para. 35: "It is now *established beyond doubt* that a general reference to ICSID arbitration in a BIT can be considered as being the written consent of the State, required by Article 25 to give jurisdiction to the Centre, and that the filing of a request by the investor is considered to be the latter's consent" (emphasis added).

20 *E.g.*, *Siemens A.G.* v. *The Argentine Republic*, Decision on Jurisdiction dated 3 August 2004, para. 142: "As regards ICSID law dealing with the issue of the rights of shareholders to bring a claim before an arbitral tribunal, the decisions of arbitral tribunals have been consistent in favor of such right of shareholders".

21 This development is foreshadowed by *Schreuer*, Article 25, para. 520.

least,[22] that the *Aguas del Tunari* Tribunal did not engage in any explicit analysis of the locally-incorporated claimant's *de facto* foreign status for the purposes of Article 25(2)(b).[23]

Aside from the exception in Article 25(2)(b), the Convention provides relatively little elucidation itself on many of the contemporary problems arising from nationality requirements raised in Dr *Happ*'s report. One further exceptional instance of a clear rule in the Convention concerns the standing of a dual national having both the nationality of another Contracting State, as well as the nationality of the host State. In *Champion Trading et. al.* v. *Arab Republic of Egypt*,[24] nationals of the United States who were also found to be Egyptian nationals were denied the right to submit their claims to ICSID on account of the "clear and specific rule" found in Article 25(2)(a).[25] This provision, which had been adopted unanimously by the Convention's drafters, ex-cludes absolutely from ICSID's jurisdiction claims by physical persons who are dual nationals having both the nationality of the host State and nationality of another Contracting State. Schreuer explains that "persons who possess the nationality of another Contracting State are excluded if they possess the host State's nationality concurrently".[26] The rule cannot be bypassed even with the parties' consent and applies irrespective of arguments as to which nationality is the more effective.[27] The Convention is clear in this respect.

The larger question whether the doctrine of dominant and effective nationality, as elucidated by the International Court *Nottebohm*[28] and, for example, applied by the

22 *Ibid*., para. 537.

23 The pre-2000 jurisprudence, based largely on contractual submissions to ICSID's jurisdiction, is discussed in *Schreuer*, *ibid*., paras. 496-607.

24 Decision on Jurisdiction dated 21 October 2003. See also *Shihata/Parra*, "The Experience of the International Centre for the Settlement of Investment Disputes" (1999) 14 ICSID Rev.-F.I.L.J. 299, 308.

25 With respect to physical persons, Article 25(2) defines "National of another Contracting State" to mean:
"(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute" (emphasis added). On the drafting history to this provision, see *Schreuer*, Article 25, para. 442.
Interestingly, the plain wording of Article 25(2)(a) would suggest that physical persons who are stateless will not have standing before the Centre: *Nathan*, ICSID Convention: The Law of the International Centre for the Settlement of Investment Disputes (2000) 84; also *Schreuer*, Article 25, para. 437.

26 *Schreuer*, Article 25, para. 440.

27 *Ibid*., para. 444.

28 *Nottebohm Case* (*Lichtenstein* v. *Guatemala*), Second Phase, Judgment dated 6 April 1955 (1955) ICJ Rep. 4, 22. On the principle of effective nationality see also *Salem Claim* (1932) II R.I.A.A. 1184, 1188; *Mergé Claim* (1955) 22 I.L.R. 443, 456; *Flegenheimer Claim* (1958-I) 25 I.L.R. 91, 149; and *Stankovic Claim* (1963) 40 I.L.R. 153, 155.

Iran-US Claims Tribunal in *Case No. A/18*,[29] is generally applicable to ICSID's requirements remains at large, notwithstanding Dr *Happ*'s view that it "seems … to have been accepted with regard to investment disputes". The question whether the principle of effective nationality has any place in investment treaty arbitration was extensively argued in *Hussein Nuaman Soufraki* v. *United Arab Emirates*, but not decided.[30] It is also adverted to in the *Champion Trading* decision, but again not decided.[31] The drafting history to the Convention suggests that possession of the nationality of a non-Contracting State in addition to that of a Contracting State is not in itself a bar to ICSID jurisdiction over dual nationals.[32] Broches himself suggested in his 1972 Hague lectures that the drafters were not concerned to legislate against such jurisdiction.[33] The question is therefore still undecided, and will no doubt be raised again in future cases,[34] but with the International Law Commission moving away from the *Nottebohm* position,[35] it is by no means clear that the doctrine of dominant and effective nationality will be adopted into ICSID law.

To conclude on the standing of physical reasons to submit claims to ICSID, writing on the scope of investment treaty arbitration in 1962, *Elihu Lauterpacht* (as he then was) considered that "where natural persons are concerned, few difficulties are likely to arise".[36] Claims have been submitted to ICSID by natural persons in at least a dozen cases[37] and, for the most part, *Lauterpacht's* forecast has been fair.

29 Decision No. Dec 32-A18-FT dated 6 April 1984, reprinted in (1984) 5 Iran-US C.T.R. 251, 263.

30 *Hussein Nuaman Soufraki* v. *The United Arab Emirates*, Award dated 7 July 2004, para. 42. Noting the Award, see *Sinclair*, Nationality of Individual Investors in ICSID Arbitration (2004) 7 *Intl. Arb. L. Rev*. 191 (hereafter "*Sinclair* (2004)"). Allen & Overy LLP represented the United Arab Emirates in this dispute and continues to do so in an annulment proceeding, which is still pending at the time of writing.

31 *Champion Trading et al.* v. *Arab Republic of Egypt*, Decision on Jurisdiction dated 21 October 2003, at p. 16.

32 ICSID, Documents Concerning the Origin and Formulation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Vol. I (Washington D.C.: ICSID, 1968) 122 (hereafter "History of the ICSID Convention"); *ibid*., Vol. II, 170, 447.

33 *Broches*, *op cit*.

34 There is also passing reference to the concept in *Feldman Karpa (Marvin Roy)* v. *United Mexican States*, Decision on Jurisdiction dated 6 December 2000, para. 32; and *Olguín (Eudoro A.)* v. *Republic of Paraguay*, Award dated 26 July 2001, para. 18.

35 *International Law Commission* (*Dugard*, Rapporteur), First Report on Diplomatic Protection, UN Doc. A/CN.4/506 (2000) 35; International Law Commission, *Draft Convention on Diplomatic Protection* (2002), Article 5(1) reprinted in *International Law Commission*, Report to the General Assembly, UN Doc. A/57/10 (2002) 166, 182; and also *Orrego Vicuña*, Interim Report to the International Law Association on Diplomatic Protection of Persons and Property, in International Law Associate Committee on Diplomatic Protection of Persons and Property, First Report (2000) at 32-33, 35 (available online at www.ila-hq.org).

36 *Lauterpacht*, The Drafting of Treaties for the Protection of Investment (1962), ICLQ Suppl. No. 3, 18.

37 See the references cited in *Sinclair* (2004), *op cit*.

However, exceptional cases such as *Soufraki* and *Champion Trading* demonstrate that the nationality issues that can arise are not always straightforward.

Just as, given the current state of the law, it cannot be said that the Convention imposes a legal test of "dominant and effective" nationality for physical persons, likewise the Convention contains no express requirement that a juridical person should have any particular connection with the Contracting State in which it is incorporated beyond the fact of incorporation. There is no general doctrine in ICSID law or investment treaty arbitration generally mitigating against jurisdiction where the claimant is a mere "shell", absent a specific limitation to that effect in the applicable treaty. Although it is a UNCITRAL case, remarks in *Saluka Investments B.V.* v. *Czech Republic*[38] are highly relevant and, on this point, had *Saluka* been an ICSID case it is very likely that the Tribunal's conclusions would have been no different. The Czech Republic had argued that Saluka was not a "real Dutch investor" but a mere conduit for an investment by *Nomura*, a UK entity. Although Article 1 of the Czech Republic-Netherlands BIT clearly extended to Saluka, since it was an entity organised in accordance with the laws of the Netherlands, the Czech Republic argued strongly against that being the end of the story and requested that the Tribunal look at the reality of the situation. The Tribunal denied the objection:

"The Tribunal has some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure and to practices of 'treaty shopping', which can share many of the disadvantages of the widely criticised practice of 'forum shopping'.

However that may be, the predominant factor which must guide the Tribunal's exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal's jurisdiction. ...The parties had complete freedom of choice in the matter, and they chose to limit entitled 'investors' to those satisfying the definition set out in Article 1 of the Treaty".[39]

Equally, the Convention's drafters chose deliberately not to import any rule that would deny jurisdiction to a juridical person that is a so-called shell, not having any substantial business activities in the territory of the Contracting State in which it is incorporated. To the extent that States may wish to exclude protection for such entities, such jurisdictional choices are, again, matters of consent that may or may not be addressed in any applicable relevant investment treaty.

Accordingly, reviewing the range of approaches in investment treaties to determine whether an investor has the nationality of a Contracting Party one can find a great deal of variation, and rightly so, since different States legitimately may take different approaches to qualification for treaty protection. There is no single appro-

38 Partial Award dated 17 March 2006.
39 *Ibid*., paras. 240-241.

priate link between an entity asserting a right to protection under an investment treaty, and the State under whose treaty the investor is seeking to benefit.[40] Many States bestow their treaty protection liberally, believing, one may surmise, that the reciprocal promotion of investment flows is best achieved by a very flexible and open definition of nationality based on mere formalities alone. On the other hand, a significant minority of States appear to take the view that the economic and developmental goals underpinning their investment treaties are best satisfied by conferring protection only upon entities with a tangible economic link to their country, such as "substantial economic activities", or their "effective management" or "main headquarters".[41] Whichever approach is the more appropriate for a particular State is a question best to be debated by economists and politicians.

Insofar as treaties contain a reference to ICSID jurisdiction, the Convention itself notoriously does not specify any particular test for nationality. The Convention thus accommodates the freedom of States to legislate who may be their nationals and to agree upon these criteria, subject to the objective outer limits of the Convention.

In time, other criteria for standing to submit claims to international fora may be developed, especially as the role of individuals as subjects of international law becomes more widely accepted.[42] For the time being, the necessary qualification to access ICSID is to have the nationality of a Contracting State although it is said that nationality for these purposes is not identical to the concept of nationality in the traditional sense of the link conferring upon a State the right in international law to espouse a claim by way of diplomatic protection.[43] Nationality, for the purposes of ICSID, merely "serves as a means of bringing the private party within the jurisdictional pale of the Centre".[44]

At one time, international investment protection had been fortuitous, but given the breadth of the network of investment protection available today, international law firms routinely advise investors on the strategic structuring of their investments. In doing so, close adherence to the diversity of treaty language is required in order to ensure that an investment benefits from the protection of an effective investment

40 For a detailed study of the tests of corporate nationality, see *Acconci*, Determining the Internationally Relevant Link between State and Corporate Investor (2004) 5 Journal of World Investment & Trade 139.

41 For a survey of the approaches, see *Sinclair*, The Substance of Nationality Requirements in Investment Treaty Arbitration (2005) 20 ICSID Rev.-F.I.L.J. 357 (hereafter "*Sinclair* (2005)").

42 *Schreuer*, Article 25, para. 431.

43 *Broches*, Chairman's Report on the Preliminary Draft of the Convention, 9 July 1964, Doc Z11, History of the ICSID Convention*, Vol. II*, 557, 579 and *Amerasinghe*, The Jurisdiction of the International Centre for the Settlement of Investment Disputes (1979) 19 Indian J. Intl. L. 166, 198, 203 (hereafter "*Amerasinghe*").

44 *Amerasinghe*, 198.

treaty and access to ICSID should a dispute arise.[45] Absent any special treaty limitation, it is not uncommon and apparently not contrary to ICSID jurisdiction to locate a new operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment, including the availability of an investment treaty.[46] Frequently, such structuring takes place in the months, or even weeks, before the crystallisation of a cause of action. This does not mean, however, that an investor of a State that is not an ICSID Contracting State may assign a *ripe* treaty claim to an entity having the nationality of a Contracting State in order to attract ICSID jurisdiction.[47] The Tribunal in *Mihaly International Corp*. v. *Democratic Socialist Republic of Sri Lanka* stated that a treaty claim "under the ICSID Convention with its carefully structured system is not a readily assignable chose in action as shares in the stock-exchange market or other types of negotiable instruments, such as promissory notes or letters of credit".[48] To allow such an assignment to operate in favour of ICSID jurisdiction would defeat the object and purpose of the Convention, as well as the sanctity of the privity of international agreements not intended to create rights and obligations for non-Convention States or their nationals.[49]

45 For example, the notion of "juridical person" in the definition of "national of a Contracting State" is not defined in the Convention but has been held to exclude unincorporated groupings: Schreuer, Article 25, para. 458 and see *Impregilo S.p.A*. v. *Islamic Republic of Pakistan*, Decision on Jurisdiction dated 22 April 2005, paras. 131-139; *Consorzio Groupement LESI-DIPENTA* v. *Republic of Algeria*, Award dated 10 January 2005, para. 40.

46 *Aguas del Tunari*, para. 330.

47 The ICSID Convention requires claimants to establish that they had the nationality of a Contracting State on the date at which the parties consented to ICSID's jurisdiction (and, in the case of natural persons only, also on the date the Request for Arbitration is registered) but does not itself require continuity of nationality, for instance, through to the date of an award: *Schreuer*, Article 25, paras. 452 (natural persons) and 493 (juridical persons). One can therefore agree with Dr *Happ* that, to the extent that a continuous nationality rule may apply at all, it is to be derived not from the ICSID Convention but from any applicable investment protection treaty; *e.g.*, *Loewen Group*, *Inc. and Raymond L. Loewen* v. *United States of America*, Award dated 26 June 2003, para. 220 determining that under NAFTA Chapter 11, the claimant must demonstrate its continuous nationality through to the date of any award. Amongst the commentary on this controversial finding, see *e.g.*, *Paulsson*, Note – *Loewen* v. *United States*, ICSID Additional Facility Case No. ARB/AF/98/3 - Continuous Nationality in *Loewen* (2004) 20 *Arb. Intl*. 213; *Duchesne*, The Continuous-Nationality-of-Claims Principle: Its Historical Development and Current Relevance to Investor-State Investment Disputes (2004) 36 Geo. Wash. Intl. L. Rev. 783; *Mendelsohn*, Runaway Train: The Continuous Nationality Rule from the *Panavezys-Saldutiskis Railway* case to *Loewen* in *Weiler* (ed.) International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Investment Treaties and Customary International Law (2005) chapter 4; *Rubins*, The Burial of an Investor-State Arbitration Claim (2005) 21 Arb. Intl. 1.

48 Award dated 15 March 2002.

49 Where an investor changes his nationality after already enjoying the protection of a BIT on the basis of its former nationality, "it is doubtful that he would continue to be deemed a national of his former country for the purposes of the BIT": *Dolzer* and *Stevens*, Bilateral Investment Treaties (1995) 34.

However, just as investors may structure their activities to benefit from investment treaty protection, so too may different States take steps to limit or avoid claims from entities to which they did not intend to extend the protection of a particular treaty. In addition to defining criteria to qualify for treaty protection, some States insert a so-called "denial of benefits" clause in their treaties that appears to be intended to confer upon host States an absolute right to exclude claims brought by shell or "mailbox" companies. The rationale for the provision may be that such companies are understood not to contribute economically or socially to the fabric of the State in which they are incorporated. Again, whether that actually is the case is a matter for analysis going beyond the scope of this paper.

Plama Consortium Ltd v. *Republic of Bulgaria*[50] is one of the few published cases to date to have addressed the application of such clauses. Plama was a company incorporated in Cyprus, which is a Contracting Party to the 1994 Energy Charter Treaty (the "ECT"). Plama indirectly owned a formerly state-owned oil refinery in Bulgaria through a locally-incorporated company, Nova Plama. When a dispute arose, Plama submitted claims against the Republic of Bulgaria to ICSID, alleging violations of both the ECT and the Bulgaria-Cyprus BIT. Bulgaria sent a letter to ICSID purporting to invoke the denial of benefits provision in Article 17(1) of the ECT and deny to the claimant the substantive protection of the ECT on the basis that: (1) Plama was owned or controlled by nationals of a State that was not a Contracting Party to the ECT; and (2) Plama conducted no substantial business activities in Cyprus. The Tribunal assumed, for the purposes of its analysis, that both requirements of Article 17(1) were met and turned to the question of how Article 17(1) was intended to operate in the context of the ECT as a whole and, specifically, in relation to the generic offer to submit investment disputes to international arbitration set out in Article 26.[51] The Tribunal stated that by operation of Article 26(3)(a) of the ECT and Article 25 of the Convention, the parties had given their unconditional written consent to the arbitration of the dispute. Such consent, once given, may not be unilaterally withdrawn.[52] As such, Article 17(1) of the ECT was congenitally incapable of constituting a bar to the Tribunal's jurisdiction to hear the claims brought under the ECT. As the Tribunal stated, Article 17(1) is not a condition precedent to the offer to submit disputes to investor-state arbitration; it created only a *right* to deny the protection of the ECT.

50 Decision on Jurisdiction dated 8 February 2005. A denial of benefits clause was also considered in *Generation Ukraine Inc. v. Ukraine*, Award dated 16 September 2003.

51 For more extensive discussion, see *Sinclair*, Investment Protection for Mailbox Companies under the 1994 Energy Charter Treaty 5(2) TDM (November, 2005); *Sinclair* (2005) *op cit*.; and *Jagusch/Sinclair*, The Limits of Protection for Investments and Investors under the Energy Charter Treaty in *Ribeiro* (ed.) Investment Arbitration and the Energy Charter Treaty (2006) 73, 93-103.

52 Article 25(1) of the Convention provides: "When the parties have given their consent, no party may withdraw its consent unilaterally".

The Tribunal went on to consider the question whether Article 17(1) could support an objection to the admissibility of Plama's claims on the merits.[53] In the Tribunal's opinion, while Article 17(1) conferred on Bulgaria a right to deny the ECT's protection to mailbox company investors, for that denial to be effective the right had to be exercised: "the existence of a right is distinct from the exercise of that right".[54] More importantly, the Tribunal held that once exercised, any denial of benefits could only apply *prospectively*. It concluded that it would run contrary to the legitimate expectations of existing investors and undermine any certainty for those planning new investments if, once invoked, the right to deny benefits provision could exclude treaty protection for existing investments.[55]

The *Plama* Tribunal's interpretation of the denial of benefits clause presents a number of practical and philosophical difficulties, which have already been described elsewhere, leading some to question its correctness.[56] If correct, however, the effect the *Plama* Tribunal gives to the denial of benefits clause has a number of practical consequences. First, it appears to have left very little scope for host States to invoke denial of benefits clauses, since by the time it becomes aware that a dispute has arisen with a mailbox company investor, it would already be too late. The denial of benefits provision can offer a good defence to claims brought by mailbox companies but a State must exercise its right prior to or at the time of the investment. Conversely, for investors deciding whether to commence arbitration proceedings or for those advising investors on structuring new investments, it is possible to take comfort that if the denial of benefits provision has not already been invoked, it may not be raised subsequently.

By way of a final remark, it is hoped that in conjunction with Dr *Happ*'s report, the foregoing analysis of nationality requirements in ICSID – and investment treaty arbitration – encourages one to share the more uncontroversial view of the *Plama* Tribunal, when it said that:

53 On the distinction between jurisdiction and the admissibility of claims, see *Paulsson*, Jurisdiction and Admissibility in *Aksen*, *Böckstiegel*, *Mustill*, *Patocchi* and *Whitesell* (eds.) *Global* Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum in Honour of *Robert Briner* (2005).

54 *Plama*, para. 155.

55 *Ibid*., para. 163.

56 See the references cited at footnote 51, above.

"issues as to citizenship, nationality, ownership, control and the scope and location of business activities can raise wide-ranging, complex and highly controversial disputes".[57]

57 *Plama*, para. 149.

State Insolvency – Consequences and Obligations under Investment Treaties

Alexander Szodruch[*]

A. Introduction

With more than 40 pending investor claims challenging Argentina's 2001/2002 pesification measures, it cannot be denied that the topic of this study, though currently being *en vogue*, is somewhat displaced in a "stocktaking" exercise. It is no doubt true that ICSID could very well exist in the absence of proceedings stemming from state insolvency. But it is worth pondering the opposite question: Will ICSID survive *in the presence* of such investor claims? Or, putting it less drastically, does the phenomenon of state insolvency have the potential to change the nature of Investment Treaty Arbitration under ICSID itself? Argentina's fierce opposition to current proceedings and to (possible) enforcement attempts illustrates that Investment Treaty Arbitration could in fact reach an important turning point when faced with claims resulting from situations of state insolvency.[1]

It is interesting to see that although much has been written about the legal implications of the Argentina crisis, there has been a separation between traditional Foreign Direct Investment (FDI) by multinational corporations on the one hand and issues arising from portfolio investment in Argentine public debt (i.e. sovereign bonds issued by Argentina in the 1990s) on the other.[2] The former debate on FDI has largely focussed on questions of ICSID jurisdiction, the interpretation of treatment obligations under BITs and Argentina's plea of State of Necessity, while the discussion on Argentina's record-breaking debt default has centred on how to cope with collective action problems traditionally surfacing in the corporate insolvency setting, the most ambitious plan being the IMF's suggestion for an institutionalized

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1 In particular, states could attempt to terminate Bilateral Investment Treaties (BITs) if they perceive that ICSID Arbitration prevents them from adopting emergency measures designed to escape an economic crisis.

2 For exceptions see *Tietje*, Die Argentinien-Krise aus Rechtlicher Sicht: Staatsanleihen und Staateninsolvenz, Beiträge zum Transnationalen Wirtschaftsrecht, Vol. 37, Feb. 2005, 13-16; *Wälde*, The Serbian Loans Case: A Precedent for Investment Treaty Protection of Foreign Debt, in *Weiler* (ed.), Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law, 2005, 383, 401-423.

Sovereign Debt Restructuring Mechanism (SDRM).[3] This separation reflects the general distinction between the Law of International Investment and the Law of International Finance, the Law of International Trade being the third leg in the triangle called International Economic Law.[4] However, given that Italian holders of defaulted Argentine bonds recently announced to initiate an ICSID claim to recover their losses from the Argentine default,[5] the implications of Investment Treaty Arbitration for sovereign debt restructuring, one of the traditional disciplines of International Financial Law, must no longer be neglected. In fact, as the IMF's SDRM proposal is shelved for the time being due to U.S. opposition,[6] it is legitimate to ask whether Investment Treaty Arbitration under ICSID can serve as an adequate international forum to solve disputes between distressed sovereign borrowers and their private lenders.[7] If ICSID Tribunals turn out to be willing and legally able to hear and decide cases brought by a distressed sovereign's creditors, the nature of Investment Treaty Arbitration could significantly depart from the original ICSID/BIT drafters' intentions.

As a starting point, I will briefly sketch the recent discussion on state insolvency and highlight the important (and partly unresolved) legal issues outside of Investment Treaty law (II.). Part III., the core of the study, will analyze the substantive ICSID/BIT implications and obligations with respect to the phenomenon of state insolvency. Part IV. will address, from an ICSID perspective, two important procedural issues that have frequently arisen in domestic sovereign debt litigation, i.e. the possibility of a temporary stay of proceedings and the prospects of enforcing creditor claims. The concluding Part V. analyzes how Investment Treaty Arbitration can alter the common sovereign debt restructuring process and, turning that very question upside down, how state insolvency claims can change the nature of Investment Treaty Arbitration. The conclusion also contains an assessment whether or not the current BIT/ICSID framework could perform functions of an SDRM and whether

3 *Anne Kruger* (then IMF First Deputy Managing Director), A Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring, Address given at the National Economists' Club Annual Members' Dinner, 26 Nov. 2001, http://www.imf.org/external/np/speeches/2001/112601.htm. The initiative was further elaborated on in the following years, see *IMF*, Proposed Features of a Sovereign Debt Restructuring Mechanism, 12 Feb. 2003, http://www.imf.org/external/np/pdr/sdrm/2003/021203.pdf.

4 *Dolzer*, Generalklauseln in Investitionsschutzverträgen, in *Frowein* et al. (eds.), Negotiating for Peace: Liber Amicorum Tono Eitel, 2003, 291 (293).

5 *Assoziazione per la Tutela Degli Investitori in Titoli Argentini*, Tfa, pronto ricorso a Icsid, 2 March 2006, http://www.tfargentina.it/download/ComunicatoStampaTFA-02_03_2006.pdf. Holders of defaulted Russian debt initiated ICSID proceedings in 1998. The case was reportedly settled, see *Freshfields Bruckhaus Deringer*, The Argentine Crisis – Foreign Investors' Rights, Jan. 2002, 3; *Wälde*, supra note 2, 402 (Fn. 44).

6 *Snow* (then Secretary of the Treasury), Statement at the Meeting of the International Monetary and Financial Committee, 12 April 2003, http://www.imf.org/external/spring/2003/imfc/stte/eng /usa.htm. ("it is neither necessary nor feasible to continue working on SDRM").

7 Debt restructurings with official lenders (states and multilateral institutions) are not covered by ICSID/BITs.

Investment Treaty Arbitration could be reconciled with the overriding principles of state insolvency identified by the IMF.

This study does not contain a current affairs discussion on the Argentina proceedings, tempting as that may be. Still, the Argentina case will quite inevitably be used to illustrate what the legal issues of state insolvency are and how currently pending ICSID proceedings could set important precedents[8] for future cases.

B. Legal Issues of State Insolvency in the Post Brady Age

Much has been written about the legal problems relating to state insolvency in the last years, which is why I will only provide a very brief overview of the core points of the subject matter. The notion of state insolvency hereinafter will refer to the case where a state does not meet (or threatens not to meet) its contractual payment obligations towards foreign nationals located abroad, regardless of whether the state is unable or only unwilling to pay.[9] In the vast majority of cases, these payment difficulties arise regarding payment obligations denominated in a foreign currency (a currency other than the state's own), as the debtor state always has the option to inflate itself out of a domestic currency payment crisis.[10] State insolvency covers all kinds of contractual payment obligations such as debt owed to suppliers and service providers. However, most prominent in the state insolvency context is the debt that states accumulate when tapping international financial markets to finance their expenditures. This is due to the fact that states are more likely to default on classic debt instruments, since the immediate welfare losses are much less significant compared to defaulting on trade credit.[11] Although the ensuing analysis will take heed of this factual practice, it should be kept in mind that state insolvency affects more claims than just those stemming from long term debt securities.

8 Arbitration under ICSID does not follow a *stare decisis* rule, and hence the term "precedent" could be misleading. It will nonetheless be used in an informal sense because ICSID Tribunals are frequently invoking prior ICSID awards as authority for their own decisions.

9 *Borchard*, State Insolvency and Foreign Bondholders, Vol. I. 1951, 115. Admittedly, this is economically inaccurate as the term insolvency only covers the situation where the debtor does not have sufficient funds to pay. However, already drawing a distinction between inability and unwillingness to pay at this definitional stage would confuse the definitional question with the question of whether or not the state actually has the right to refuse payments, see *Ohler*, Der Staatsbankrott, JZ 2005, 590, 593.

10 The Russian default on ruble denominated Russian Law debt obligations (GKOs) in 1998 illustrates that local currency debt is not immune from default either, see *Gelpern/Setser*, Domestic and External Debt: The Doomed Quest for Equal Treatment, 35 Geo. J. Int'l L. 795, 801 (2004).

11 *Samberg*, Debt Restructuring: Trade Finance Falls from Favour, Int'l Fin. L. Rev. Sept. 2002, 21, who notes that the traditional pattern of sparing trade creditors from restructuring is changing.

The most important feature that renders the problem of state insolvency so complex is the fact that sovereign debt is now mainly issued in the form of bonds that are freely traded on securities exchanges. This constitutes a remarkable departure from sovereign financing through syndicated bank loans in the 1970s/80s and can be traced back to the 1989 *Brady*-plan (named after then U.S. Secretary of the Treasury *Nicholas Brady*) that swapped bank debt for tradable debt securities.[12] Moreover, throughout the 1990s, many emerging market countries issued new debt securities to a variety of receptive investors, including retail investors. This development dramatically changed the sovereigns' foreign creditor base from a limited number of large western commercial banks to millions of investors ranging from U.S. Hedge Funds to Italian retirees and German dentists.[13]

What is important from a legal point of view is that sovereign bonds are (undisputedly) private law instruments that contain express (and valid) choice of law clauses,[14] mostly declaring the law of the place of issuance applicable, i.e. the law of New York or the U.K., with Japanese and German law having a much smaller share.[15] On the other hand, we are only recently witnessing states issuing debt instruments under their own laws that are open for foreigners to buy. Another significant feature of foreign law debt instruments are waiver of immunity clauses whereby the debtor state unequivocally submits to the jurisdiction of foreign courts and *ex ante* waives any immunity defences.[16] These contractual provisions already highlight a fundamental difference to traditional FDI where the investment contracts are often governed by the law of the host state and contain choice of forum clauses in favour of the local courts of the host state. Presumably, this reflects both a difference in bargaining power on the part of the foreign investors as well as the more territorial nature of the FDI contracts. Debt securities are not as easily associated with a domestic legal order as, say, the construction of a factory on foreign soil.

12 *Buckley*, The Facilitation of the Brady Plan: Emerging Markets Debt Trading from 1989 to 1993, 21 Fordham Int'l L. J. 1802, 1804-1818 (1998).

13 *Fisch/Gentile*, Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring, 53 Emory L. J. 1053, 1070 ff. (2004).

14 *Siebel*, Rechtsfragen Internationaler Anleihen, 1997, 191.

15 In September 2005, 63% of the outstanding emerging market debt (USD 264 bn.) was governed by New York law, 29% (USD 120 bn.) by English law, 5% (USD 20 bn.) by German law and 3% (USD 12 bn.) by Japanese law, *IMF*, Progress Report on Crisis Resolution, 21 Sept. 2005, 15. http://www.imf.org/external/np/pp/eng/2005/092105.pdf.

16 This is in line with most legal systems that adhere to the restricted theory of state immunity and consider debt instruments acts *iure gestionis*, *Reinisch*, Anm. zu LG Frankfurt Judgment of 14 March 2003, JZ 2003, 1013, 1014 with further references.

II. The Current Restructuring Process

Despite a long history of ideas to form an institutionalized sovereign debt mechanism, such a mechanism is still lacking. Debtors and creditors have so far looked for alternative avenues to find acceptable solutions for state insolvencies. It is interesting for our later analysis to observe that debtor states have employed different restructuring techniques depending on whether the debt instruments were governed by foreign law or by the law of the debtor state.

In cases of foreign law debt, restructuring has largely meant that – in some cases after negotiating with a creditor committee – the debtor makes an offer to its creditors to swap its old debt claims for new ones that contain more favourable terms for the debtor (such as extended maturity, reduced interest or in some cases also debt relief in the form of decreased principal payments). Some of these restructurings have been pre-emptive, i.e. before a cessation of payments (an event of default) occurred, while others such as Ecuador (2000) and Argentina (2005) have been post-default restructurings.[17] Much ink has been spent on whether collective action problems could be mitigated by allowing a majority of creditors (say 75%) to bind a minority that is unwilling to accept a swap offer (the holdout creditors) and how corresponding contractual clauses could be drafted. At the time of writing this paper, drafting practice in New York embraces such a contractual approach and incorporates Collective Action Clauses (CACs), already a common feature in English and Japanese law bonds, into sovereign bonds.[18] Although recent experience with the Uruguayan restructuring 2003 is positive,[19] it remains to be seen whether or not CACs will actually be an effective tool for more orderly debt restructurings. Regardless of recent developments in drafting practice, there is still a large stock of foreign law debt outstanding that does not allow for majority restructuring, meaning that only those bondholders who accept a debt swap offer will be bound by the restructuring terms.[20]

Contrary to the debt swap methods employed to restructure foreign law debt, states have occasionally made use of their law making powers to restructure domestic law debt. They adopted laws amending the terms of the debt or the modes of debt servicing, irrespective of whether these debt instruments were held by domestic or

17 See *Fisch/Gentile*, supra note 13, 1069 f.

18 For a coherent analysis of recent market practice see *Drage/Hovaguimian*, Collective Action Clauses: An Analysis of Provisions Included in Recent Sovereign Bond Issues, Financial Stability Review by the Bank of England, Nov. 2004, http://www.bankofengland.co.uk/publications/fsr/2004/fsr17art9.pdf. German law bonds still do not contain CACs as counsel to the issuers and underwriting banks fear that such clauses could be struck down on consumer protection grounds, see *Schneider*, Die Änderung der Anleihebedingungen durch Beschluss der Gläubiger, in *Baums/Cahn* (eds.), Die Reform des Schuldverschreibungsrechts, 2004, 69, 87.

19 *Steneri*, Uruguay Debt Reprofiling: Lessons from Experience, 35 Geo. J. Int'l L. 731, 748 (Fn. 31) (2004).

20 In June 2005, 47% of outstanding emerging market foreign law debt did not include CACs, *IMF*, supra note 15, 3.

foreign creditors. Russia in 1998 serviced the GKOs held by foreigners into blocked accounts, the proceeds being convertible into dollars only on a very restricted basis. Argentina took a more drastic step in 2002 when it unilaterally converted domestic law dollar bonds into peso debt.[21] It strikes the eye that these coercive restructurings could give rise to Investment Treaty claims.

III. Sovereign Debt Litigation

As the creditor group in the post-Brady age is much more heterogeneous than in the 1980s, the recent debates highlighted the (perceived) threat that creditors would no longer behave as a group acting in the common interest but would rush to the courts and recover as much from their debt holdings as possible, thereby obstructing an orderly debt restructuring process. The case of Argentina where creditors took to the courts in multiple jurisdictions such as Italy, Germany and the U.S. (where a court certified the first class action suit against a sovereign state)[22] could serve as proof that the "rush to the courthouse"-threat is real. However, other debt restructurings, even highly controversial ones such as Ecuador in 2000,[23] have not seen creditor litigation, let alone an asset-grabbing race.

The success of holdout creditor litigation in domestic courts has largely depended on where they brought suit. New York courts (the most prominent forum given the choice of forum clauses in most debt instruments) have generally ruled in favour of the creditors, rejecting sovereign defences such as the Act of State Doctrine or the famous Art. VIII (2) (b) of the IMF Agreement.[24] In Germany, there is still a case pending before the Federal Constitutional Court (*Bundesverfassungsgericht*) on whether Argentina can invoke a public international law State of Necessity defence,[25] and in April 2005 the Italian *Corte di Cassazione* held that Italian courts lacked jurisdiction to hear bondholder claims against Argentina on the principle of

21 See *Gelpern/Setser*, supra note 10, 802-803, 806.

22 *Debevoise/Orta*, The Class Action Threat to Sovereign Workouts, Int'l Fin. L. Rev July 2003, 41-44.

23 Ecuador made use of a coercive restructuring technique borrowed from U.S. corporate restructuring known as exit consents, see *Buchheit/Gulati*, Exit Consents in Sovereign Bond Exchanges, 48 UCLA L. Rev., 59-84 (2000). The technique was only recently validated, *Greylock v. Mendoza*, No. 04 Civ. 7643 (HB), 2005 U.S. Dist LEXIS 1742 (S.D.N.Y. 7 Feb. 2005), aff'd *Greylock v. Mendoza*, No. 05-1414-CV, 2006 U.S. App. 1501 (2nd Cir. 18 Jan. 2006).

24 *Allied Bank International et. al. v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 520-522 (2nd Cir. 1985). For an Argentina case see *Lightwater Corp. et. al. v. Argentina*, No. 02 Civ. 3804, 3808, 5932 (TPG), 2003 U.S. Dist. LEXIS 6156 (S.D.N.Y. 14 April 2003), 11. *Libra Bank v. Banco Nacional de Costa Rica*, 570 F.2d 870, 900 (2nd Cir. 1983).

25 See *inter alia* the request for a preliminary ruling (Vorlagebeschluss) by OLG Frankfurt/M. NJW 2003, 2688.

par in parem non habet jurisdictionem, holding that the Argentine default was an act *iure imperii* that Italian courts could not sit in judgment over.[26]

Even where creditors obtained a judgment in their favour, they have largely been unable to actually collect on it.[27] This is due to the traditional international law concept of immunity from enforcement which prevents creditors from attaching assets used for *iure imperii* purposes.[28] As states are eager not to park commercial assets abroad,[29] payment awards are little useful at the end of the day. In 2000, the notorious decision of the Brussels Court of Appeals in *Elliott v. Peru*[30] suggested that holdout creditors had ultimately overcome the classic enforcement dilemma as it enabled them to stop the debt swaps with those creditors willing to tender their old bonds. However, recent U.S. court judgments[31] and a subsequent ruling of that very Brussels Court[32] indicate that the Elliott-jurisprudence was very short lived and that the old obstacles to enforcement remain. Enforcing debt claims in the debtor state itself seems unlikely at best. Local enforcement authorities are not obliged to enforce foreign court judgments in the absence of a Treaty obligation. Even where a Treaty on the recognition and enforcement of judgments exists, it is subject to a public policy review by local authorities.[33]

Where foreign investors have sued on their domestic law bonds in the debtor state's courts, they have largely been unsuccessful as the courts applied the domestic emergency laws over the principle of *pacta sunt servanda*.[34]

26 Corte Suprema di Cassazione, Sezioni Uniti Civili, 21 April 2005, Docket No. 11225/05 (on file with author). For an English brief see *Cleary Gottlieb Steen Hamilton*, Argentina in Italian Supreme Court Win in Bond Payment Suspension Suit, News Bulletin 27 May 2005, http://www.cgsh.com/english/news/NewsDetail.aspx?id=2523.

27 *Gelpern*, What Bond Markets Can Learn from Argentina, Int'l Fin. L. Rev. April 2005, 19, 21.

28 Whether or not the far reaching immunity waiver clauses also waive immunity from attaching *iure imperii* assets is a question in the pending German BVerfG proceedings, see *Pfeiffer/Kopp*, Der Imunitätsverzicht in Staatsanleihen und seine Reichweite, 102 ZVglRWiss 563-573 (2003).

29 One of the popular cases was Argentina's president *Kirchner* cancelling a visit to Germany, fearing attachment of his presidential aircraft, see Handelsblatt, Tango-König verzichtet auf Tango, 13 Oct. 2003 (No. 196), 21.

30 Het Hoef van Beroep de Brussel (8ste Kamer), 26 Sept. 2000, Docket No. 2000/QR/92 (on file with author).

31 *EM Ltd. et al. v. Argentina*, No. 05-1525-cv, 2005 U.S. App. LEXIS 8599 (2nd Cir. 13 May 2005).

32 See Latin Finance, Nicaragua Beats the Vultures, June 2004, 38.

33 As to the possibility of enforcing German judgments in Argentina see *Baars/Böckel*, Argentinische Auslandsanleihen vor Deutschen und Ausländischen Gerichten, ZBB 2004, 445, 463.

34 For litigation as a result of the 1998 Russian default see *Nadmitov*, Russian Debt Restructuring – International Finance Seminar, 27, http://www.law.harvard.edu/programs/pifs/pdfs/Alexander_nadmitov.pdf. As to the proceedings in Argentine courts on the pesification of domestic law debt see *Baars/Böckel*, supra note 33, 462.

C. Bilateral Investment Treaty Obligations and ICSID

The above analysis of recent state insolvency cases shows that in the restructuring process, the debtor state is in a much stronger position than the creditors, especially since the prospects for enforcement remain slim. This difference in bargaining power necessarily affects the outcome of restructuring negotiations, as the creditors do not have much leverage against the debtor, the times of gun-boat diplomacy to enforce private party claims (luckily) being long gone. We will now assess whether Investment Treaty Arbitration under ICSID has the potential to shift power to the creditors and provide them with more leverage in debt restructurings.

I. Applicability of BITs to Sovereign Debt

It is noteworthy that debt instruments traditionally lack arbitration clauses and instead refer disputes between the parties exclusively to domestic courts.[35] Hence, the only way for ICSID to come into play lies in the respective BIT clauses. This raises the question whether the specific treatment obligations are applicable to sovereign debt in the first place.

1. Ratione Materiae

There is reliable authority for the assumption that the traditionally broad investment definition of Art. 25 ICSID encompasses loans and bonds, whether issued by private or public entities.[36] Interestingly, no state has thus far made use of Art. 25 (4) ICSID to exempt sovereign debt disputes from ICSID Arbitration.

The more precarious question is whether the debt instruments are investments in the meaning of BITs. So far, we have not seen a coherent practice on this question. Some investment protection instruments such as the E.U.-ACP Investment Principles[37] or the Italy–Argentina BIT[38] expressly include public debt held by nationals of

35 *Ebenroth/Dillon*, Arbitration Clauses in International Financial Agreements, 10 J. Int'l Arb. 5, 22 (1993). Recent commentators have promoted the inclusion of ICSID arbitration clauses in sovereign bonds, *Griffin/Farren*, How ICSID Can Protect Sovereign Bondholders, Int'l Fin. L. Rev. Sept. 2005, 21-24.

36 *Fedax v. Venezuela (Decision on Objections to Jurisdiction)*, Case No. ARB/96/3, 37 I.L.M. 1384 (1998), para. 29. *Delaume*, ICSID and the Transnational Financial Community, 1 ICSID Rev. – F.I.L.J., 237 (1986), 242, referring to the drafting history of the Convention.

37 Council of the European Communities: „Community Position on Investment Protection Principles in the ACP-States", ACP-CEE 2172/, 3 Nov 1992, 5.

38 http://www.unctad.org/sections/dite/iia/docs/bits/italy_argentina_it.pdf, Art. 1 lit. c.

the other state party. Also, the recent U.S.-Uruguay BIT[39] indicates that the U.S. government regards public debt as a covered investment. On the other hand, the Canadian Model BIT[40] expressly excludes public debt instruments. Other treaty clauses are rather ambiguous and open to interpretation. The Tribunal in Fedax in 1997 decided that promissory notes issued by a state were covered by the notion of "Titles to Money" in the Netherlands-Venezuela-BIT.[41] The Tribunal drew an express analogy to the issuance of long term debt instruments such as bonds and loans which it implicitly assumed would no doubt qualify as "Titles to Money" as they would serve to finance the country's needs.[42] Taking *Fedax* as precedent and combining this with a number of BITs that expressly cover public debt, we cannot but conclude that sovereign debt will qualify *ratione materiae* as investments for the sake of BIT Arbitration unless there is an express opposite treaty provision.

2. Ratione Loci

One possible objection to the application of BITs could be that financial instruments such as bonds or syndicated loans are not made "in the territory" of the debtor state as required by most BITs.[43] The difficulty with applying this "territoriality criterion" to sovereign debt is that financial instruments, as opposed to traditional FDI, are intangible and that therefore the *situs* of the investment is difficult to determine. Indeed, it would not seem too far off to argue that a sovereign bond, traded on the NYSE, payable on a U.S. bank account, governed by New York law and purchased from a U.S. broker/dealer is not an investment "in the territory" of the debtor state. However, both recent BIT- and (even more so) ICSID jurisprudence are abundantly clear that such objections will not be sustained. The 2004 BIT between the U.S. and Uruguay, which maintains the territoriality criterion, implicitly acknowledges that debt instruments governed by New York law do fall within the ambit of the BIT.[44] And the Fedax Tribunal expressly states that the *situs* of a debt instrument (wherever it is) is irrelevant, as long as "the funds made available are utilized by the beneficiary of the credit …so as to finance its various governmental needs".[45] The Tribunal in *CSOB* adopts a similar approach, holding that the "in the territory"-requirement is satisfied where the investment is designed to benefit the economic

39 Treaty between the U.S.A. and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, Annex G, http://www.unctad.org/sections/dite/iia/docs/bits/US_Uruguay.pdf.

40 http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf, 4.

41 *Fedax v. Venezuela (Jurisdiction)*, supra note 36, paras. 30 ff.

42 *Id.*, at 1386.

43 See U.S. Model BIT Nov. 2004, Preamble ("… investment in the territory of the other Party…"), http://ita.law.uvic.ca/documents/USmodelbitnov04.pdf.

44 U.S.-Uruguay BIT, supra note 39, Annex G, 54.

45 *Fedax v. Venezuala (Jurisdiction)*, supra note 36, para. 40.

development of the receiving state, even where the investment is made in an entirely intangible form (such as a loan).[46] This also implies that there is no distinction between domestic law debt and foreign law debt, an important difference to the SDRM proposal that expressly excluded domestic law debt.[47]

3. Ratione Personae

Although public debt instruments often fall within the ambit of a BIT *ratione materiae*, the *ratione personae* scope of BITs, i.e. the question which investors actually benefit from the BIT guarantees, illustrates that BITs are primarily designed for FDI and not so much for portfolio investment. The typical BIT/ICSID yardstick is the nationality of the investor. In the area of traditional FDI, where the investment cannot easily be transferred from one investor to the other, this might be adequate a standard. By contrast, the nationality criterion could prove inappropriate in globalized financial markets where the investment (public debt) is traded on secondary markets and can freely change hands from one national to the other within seconds.[48] Strictly applying the nationality criterion could lead to the undesirable result that the investment would be granted different legal protection depending on who the holder is. This could not only prejudice the fungibility of the debt instruments[49] but would also run counter to the fundamental principle in sovereign debt restructuring that requires holders of similar claims be granted similar treatment.[50] Admittedly, most favoured nation (MFN) clauses in BITs could mitigate this problem and level the playing field with regard to certain treatment obligations (i.e. if some BITs of the debtor state contain umbrella clauses, while others do not, even those nationals who would not at first glance benefit from the umbrella clause could

46 *Ceskoslovenska Obchodni Bank v. Slovakia* (Decision on Objections to Jurisdiction), Case No. ARB/97/4, 14 ICSID Rev. – F.I.L.J. 251 (1999), para. 88. The Tribunal in SGS v. Pakistan (Decision on Objections to Jurisdiction), Case No. ARB/01/13, 18 ICSID Rev. – F.I.L.J. 307 (2003), para. 136, held that the "injection of funds into the territory" suffices. However, the context of this case was different as it related to the opening of offices in the host state. In *SGS v. The Philippines* (Decision on Objections to Jurisdiction), Case No. ARB/02/6, reprinted in *Crawford/Lee/E. Lauterpacht* (eds.), ICSID Reports, Vol. 8 2005, para. 110, the Tribunal noticed that Fedax had adopted a "very broad definition of territoriality" (Fn. 41). Whether the SGS decisions support the broad Fedax notion of territoriality, *Alexandrov*, The "Baby Boom" of Treaty-based Arbitrations and the Jurisdiction of the ICSID Tribunals, 4 LPICT 19, 47 (2005), is doubtable against this background.

47 *IMF*, supra note 3, 23.

48 The Tribunal in Fedax implicitely acknowledged this consequence, see *Fedax v. Venezuela (Jurisdiction)*, supra note 36, para. 40 ("the identity of the investor will change with every endorsement").

49 As to the fundamental value of fungibility, see *Kümpel*, Bank- und Kapitalmarktrecht, 3rd ed. 2004, 1417.

50 *Clark*, Sovereign Debt Restructurings: Parity of Treatment between Equivalent Creditors in Relation to Comparable Debts, 20 Int'l L. 857, 858 (1986).

invoke such a clause relying on MFN in "their" BIT).[51] Nonetheless, it is much more debatable whether MFN clauses can remedy a situation when the *ratione materiae* scope of BITs varies, i.e. when one BIT does cover public debt (U.S.) while the other does not (Canada). Tribunal practice suggests that MFN clauses cannot broaden the scope of BIT protection because the other BITs are *res inter alios acta* in this respect.[52] To the contrary, it is has been argued that MFN clauses actually do entitle investors to choose the most favourable investment definition from all BITs the opposing state party has concluded.[53] In a setting where a Canadian investor holds debt issued by a state that has BITs with both the U.S. and Canada, an ICSID Tribunal would have to reach a decision on this difficult question. These problems arise whenever portfolio investments are covered by BITs, sovereign debt only being one instance where the *ratione personae* problem could surface.

II. Contract Claims v. Treaty Claims and the Umbrella Clause

Our next issue will be of fundamental importance for the outcome and in fact for the very nature of ICSID-state insolvency cases. The more regrettable it is that ICSID-decisions are very difficult to predict on the topic: The relationship between contract and treaty claims and the meaning of umbrella clauses. While the problem already causes permanent controversy in the classic FDI setting, it is aggravated in the state insolvency context. It will be remembered that sovereign bonds, the investments of primary interest here, certify contractual obligations by which the debtor promises to pay a certain amount of money on a specific date with a fixed (or floating) interest rate. In contrast to the recent ICSID cases that sparked the debate on contract/treaty claims, the contract claim against the host state is not part of a larger operation (such as a concession contract for providing services): The contractual claim is the investment itself. Therefore, it does not come as a surprise that the exact elaboration on the relationship between contract and treaty claims will be the core task for any ICSID Tribunal in future state insolvency cases. A full-fledged analysis of this topic would certainly exceed the scope of this study,[54] so I will restrain myself to highlighting the consequences of the different approaches for our subject of interest.

51 The application of umbrella clauses through MFN clauses was addressed but left undecided in *Impregilo S.p.A. v. Pakistan (Decision on Jurisdiction)*, Case No. ARB/03/3, 22 April 2005, para. 223, http://www.worldbank.org/icsid/cases/impreglio-decision.pdf.

52 *Maffezini v. Spain (Decision on Objections to Jurisdiction)*, Case No. ARB/97/7, 16 ICSID Rev. – F.I.L.J. 212 (2001), para. 45. *Impreglio v. Pakistan*, supra note 51, para. 223.

53 *Rubins*, The Notion of Investment in Investment Treaty Arbitration, in Horn (ed.), Arbitrating Foreign Investment Disputes, 2004, 322-323.

54 For recent analyses see *Shany*, Contract Claims v. Treaty Claims, 99 Am. J. Int'l L. 835-851 (2005). *Cremades/Cairns*, Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes, in *Horn* (ed.), supra note 53, 325-351. *Gaillard*, Investment Treaty Arbitration and Jurisdiction over Contract Claims – The SGS Cases Considered, in *Weiler* (ed.), supra note 2, 325-347.

Although each individual case depends on the wording of the applicable BIT, two general approaches in ICSID jurisprudence can be identified, recently described as integrationist and disintegrationist.[55]

The "integrationist Tribunals" in *Fedax*,[56] *SGS v. Philippines* and most recently *Eureko* and *Noble Ventures v. Romania*[57] interpret BIT umbrella clauses to elevate any contractual investor claim against the state to treaty claim status. Consequently, under this approach, every breach of contract amounts to a breach of the treaty. A sovereign default would, subject to possible defences under domestic and international law, amount to a treaty violation. The "integrationists" would thus do away with the long standing view in international law that the non-payment of public debt, although being a breach of contract, is not an international wrong.[58] From a procedural point of view, "integrationist Tribunals" would have to deal with choice of forum clauses in the debt instruments and assess whether they should follow the (2:1) decision in *SGS v. Philippines* and defer the determination of breach of contract to domestic courts to avoid parallel proceedings.[59]

"Disintegrationist Tribunals" interpret umbrella clauses in a more restrictive manner and draw a distinction between contract claims arising under municipal law and treaty claims arising under the BIT. Under this approach, which seemed to prevail until *Noble v. Romania*, breaches of contract do not constitute treaty violations unless the state makes use of its governmental (*iure imperii*) powers to interfere with the contractual rights of the investor.[60] It is argued that breaches of contract are the commercial risk, a risk that BITs do not seek to insure against. For state insolvency cases, this line of argumentation would have implications fundamentally different from the "integrationists": ICSID Tribunals will not decide disputes where the only issue is that a state missed due payments under a debt instrument: The non-payment

55 *Shany*, supra note 54, 844.

56 *Fedax v. Venezuela (Award)*, Case No. ARB/96/3, 37 I.L.M. 1391, 1396 (1998).

57 *SGS v. Philippines (Jurisdiction)*, supra note 46, para. 116, 117, 127. *Eureko B.V. v. Poland (Partial Award)*, Ad hoc Arbitration, 19 Aug. 2005, paras. 244 ff., http://ita.law.uvic.ca/documents/Eureko-PartialAwardandDissentingOpinion.pdf. *Noble Ventures v. Romania*, ICSID Case No. ARB/01/11, 5 Oct. 2005, para. 54, http://ita.law.uvic.ca/documents/Noble.pdf.

58 *García-Amador*, Second Report on State Responsibility, UN Doc. A/CN.4/106, I.L.C. Yb. 1957-II, 117. *Borchard*, supra note 9, 118-120. That view was also widely shared during the negotiations for the multilateral Agreement on Investment (MAI), see *OECD*, The Multilateral Agreement on Investment – Commentary to the Consolidated Text, 22 April 1998, OECD Doc. DAFFE/MAI(98)8/REV 1, 23.

59 *SGS v. Philippines (Jurisdiction)*, supra note 46, para. 155 and Declaration by Arbiter *Crivallero*.

60 *CMS v. Argentina (Award)*, Case No. ARB/01/8, 44 I.L.M. 1205 (Sept. 2005), para. 299. *Impreglio v, Pakistan*, supra note 51, para. 260. *Joy Mining v. Egypt* (*Award on Jurisdiction*), Case No. ARB/03/11, 44 I.L.M. 73 (Jan. 2005), paras. 77-82. *SGS v. Pakistan*, supra note 46, paras. 165 ff. On the even more restrictive general principle of international law, see Restatement (Third) of the Law, § 712 (1987).

of one's debt is an act *iure gestionis*[61] and constitutes the commercial risk that a creditor is aware of when purchasing emerging market debt (which often yields spectacular returns). ICSID would have to assess whether the government, in one way or the other, invokes its genuine *iure imperii* powers to justify non payment.[62]

The importance of the contract claims/treaty claims question cannot be overstated. Depending on whether ICSID Tribunals will adjudicate over pure contractual disputes or constrain themselves to mere treaty claims, the nature of the proceedings will vary significantly. Both options bear their own problems. An "integrationist Tribunal" would stigmatize a mere non-payment as an international wrong and politicize sovereign debt restructurings.[63] Moreover, it would (arguably) run the risk of being abused as an enforcement tool for domestic court decisions. The latter concern holds particularly true if one subscribes to the *SGS v. Philippines* Tribunal's view that whenever a local judge rules in the investor's favour, compliance with this judgment becomes a treaty obligation.[64] "Disintegrationist Tribunals" would have to address the highly complex question of the extraterritorial effect of *iure imperii* acts, the issue we will turn to next.

III. Extraterritorial Application of Emergency Laws

The distinction between *iure imperii* and *iure gestionis* acts is certainly of some helpful guidance in the context of traditional FDI where the investor enters the host state's territory and subjects its investment to the laws of that state. However, in the context of external public debt, where it is often the state that subjects itself to the laws of some other country upon the express request of the investor,[65] the distinction of *iure imperii* and *iure gestionis* acts gives rise to the problem of the extraterritorial application of domestic laws (conflicts of public law norms). How can a sovereign debtor ever assume *iure imperii* powers to interfere with an investment (and thereby trigger a treaty claim) when the investment is exclusively governed by the laws of the State of New York, is to be repaid in New York on an account with a New York bank?

The general question of the extraterritorial application of domestic laws is certainly one of the most disputed fields in International Economic Law, and scholars of private international law even deny that it is a matter of public international law at

61 Mixed Tribunal of Cairo, 15 June 1925, stating that "the refusal to pay … has never been an act of sovereignty, or an act of public authority, because any private individual may do the same. The mere fact that the debtor is a state can make no difference", quoted after *Borchard*, supra note 9, 11 (Fn. 7).

62 *Wälde*, supra note 2, 408.

63 Especially regarding the diplomatic tools in the hands of the creditors' home governments, see infra. IV. 2.

64 *SGS v. Philippinies (Jurisdiction)*, supra note 46, paras. 127, 128, 163.

65 See supra II. 1.

all.[66] However, when faced with an investment dispute, ICSID cannot help but make a decision.

1. Domestic Law Debt

The situation of domestic law debt in this regard appears to be less complex than foreign law debt as it resembles the traditional FDI situation where the foreign investor submits to the laws of the debtor state. Let us assume *arguendo* that the choice of domestic law renders the sovereign competent to amend its laws and thereby affect its debt servicing obligations towards foreigners.[67] If the state actually makes use of this competence, this exercise of classic *iure imperii* powers will be tested against the state's obligations under international law (i.e. BITs).[68] One possible argument for the debtor state could be that the creditor assumed the risk by voluntarily submitting to the local laws and receiving a higher risk premium as compensation and therefore acts in bad faith bringing an ICSID claim. It is unlikely that this would indeed prevent an in depth analysis of BIT investment disciplines.

2. Foreign Law Debt

Let me now turn to the more complicated issue on how treaty claims stemming from the use of *iure imperii* powers could possibly arise in the context of debt contracts governed by foreign law. We have already seen that generally, the mere non-payment of one's debts is not an act *iure imperii*, just as the conclusion of the very debt contract is a commercial and not a sovereign act. Every private debtor can do the same. The difference between corporate and state insolvency is that states tend to adopt debt moratoria in the form of emergency laws to declare the cessation of pay-

66 *Sonnenberger*, in Münchener Kommentar zum EGBGB, 4th ed. 2006, intro. to EGBGB, paras. 123, 413.

67 Unfortunately, this question is far from settled. In English law the above assumption is correct, *Kahler v. Midland Bank*, [1950] A.C. 24, 56 per *Lord Radcliffe*. To the contrary, German courts have a strictly territorial approach, refusing to give effect to foreign public law norms even when that is the proper law of the contract, BGH NJW 1960, 1101, 1102. The traditional French doctrine of *contract international* adopts an approach similar to the German one and was applied in the classic Serbian Loans Cases before the PCIJ in 1929, but purely as a matter of French law, *Case Concerning the Payment of Various Serbian Loans Issued in France,* PCIJ Ser. A Nos. 20/21, 46-47. The ICJ case had ample opportunity to rule on the issue but refused to hear the case on the merits, ICJ, *Case of Certain Norwegian Loans*, ICJ Rep. 1957, 9, 27, diss. op. by Judge *Read*, 85.

68 On this general principle of international law see *Sir H. Lauterpacht*, *Case of Certain Norwegian Loans,* sep. op., supra note 67, 37.

ments on their external debts.[69] By intention, these laws have an extraterritorial reach. Prior to any examination on whether the emergency laws comply with substantive BIT obligations, an ICSID Tribunal has to assess whether it gives effect to a debt moratorium despite its extraterritorial reach. Although, as far as the author is aware, ICSID Tribunals have not had to deal with this issue, two alternative solutions can be identified. Arguably, the outcome of ICSID proceedings on the issue will depend on whether the arbiters have a public international law or private international law background.

The private international law approach: Arbiters regarding the question of extraterritorial application of public law norms primarily as a question of conflicts of laws would presumably rely on jurisprudence in the forum of the proper law, especially when there are judgments on the very same issue of state insolvency. Where a local court has already declined to give effect to the debtor state's emergency laws because of their extraterritorial reach (as is the case in U.S. 2nd Circuit law),[70] a "disintegrationist" Tribunal could defer to such a ruling and consequently refuse to analyze the specific BIT disciplines. This would be advantageous since, firstly, it would avoid diverging decisions between ICSID and domestic courts on the same case and, secondly, it would also mitigate the "abuse-threat" (i.e. judgment creditors taking to ICSID who have been unsuccessful in collecting on their domestic law judgments). Yet, the major disadvantage lies in the fact that domestic *fora* themselves are inconsistent on whether to recognize extraterritorially reaching emergency laws. A look at the recent Argentine insolvency highlights the dilemma of the private international law approach: The Italian *Corte di Cassazione* is diametrically opposed to 2nd Circuit jurisprudence as it expressly acknowledges that the emergency laws on the cessation of payments constitute non-justiceable *iure imperii* acts, thus implicitly giving them the sought extraterritorial effect without even elaborating on the extraterritoriality problem.[71] In an Italian Bondholder v. Argentina case before a "disintegrationist" Tribunal, Argentina would probably be estopped from raising a "*contract-claim-defence*" as it (successfully) invoked its sovereign powers in Italian courts in the very same case.[72] Thus, under a private international law approach, the inconsistencies of national jurisprudence could cause another line of inconsistent ICSID decisions. Ironically, at the end of the day, the Italian investor might be better off than his U.S. counterpart because ICSID awards can be better enforced than U.S. judgments.

The public international law approach: As an alternative solution, ICSID could engage in an autonomous assessment on whether a debt moratorium can, despite its extraterritorial reach, affect foreign law debt contracts. Although this approach has

69 See the Argentine Emergency Law No. 25. 561 dated 6 Jan. 2002 and the debt moratorium under this Emergency Law No. 256/2002, dated 6 Feb. 2002.

70 See supra II. 3.

71 Corte Suprema di Cassazione, supra note 26, 5.

72 In *SGS v. Pakistan (Jurisdiction)*, supra note 46, para. 139, an ICSID Tribunal held Pakistan to its pleadings in foreign (Swiss) courts that certain acts were non-justiceable *iure imperii* acts.

the advantage of allowing a coherent ICSID jurisprudence to develop, it would soon face the problem that practice-proof international law rules on the extraterritorial application of domestic law are very difficult to detect.[73] One possible yardstick would be the requirement of a *bona fide* connection between the subject matter and the respective state laws,[74] a test that would presumably be satisfied where a state enacts laws specifically designed to affect its own contracts. This is of course not to say that the emergency measures are BIT-legal, quite the contrary is true: The (applicable) measures would in a later step have to be tested against the BIT obligations of the state. The fundamental problem with an autonomous assessment is that the outcome will necessarily conflict with some national court judgment, which is most drastic when domestic courts and ICSID decide over the very same emergency measures (as could be the case with U.S. courts, Italian courts and ICSID deciding on the Argentine emergency measures). For the sake of coherent ICSID jurisprudence, the public international law approach would have to choose between either denying justice to Italian bondholders or (arguably) being abused by American creditors.[75]

The analysis shows that both possible approaches have material disadvantages, and there does not seem to be a way to escape this dilemma. Nonetheless, the issue would have to be solved in one way or the other by a "disintegrationist" Tribunal that only looks at cases where the state has made use of its *iure imperii* powers.

IV. Treatment Obligations under BITs

We now head back to the more known territory of Investment Law, the individual BIT treatment obligations. Whether or not a Tribunal actually reaches this stage will largely depend on its stance on the two prior issues. This study does not provide a full-fledged analysis on every individual investment discipline, given that much is still in flux and that some topics are also addressed separately at this conference. In

73 *Dolzer*, Extraterritoriale Anwendung von nationalem Recht aus der Sicht des Völkerrechts, Bitburger Gespräche, Jahrbuch 2003, 71, 79.

74 *Brownlie*, Principles of Public International Law, 6th ed. 2003, 309, with further references. The WTO Appellate Body employs a "sufficient nexus"-test, Report of the WTO Appellate Body Report, *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 Oct. 1998, para. 133.

75 The *deni de justice* claim from Italian bondholders would sound like this: While Italian Courts are not hearing our case because the measures complained of are considered non-justiceable *iure imperii* acts, the "disintegrationist" ICSID Tribunal considers them ineffective and thus refuses to hear our pure *iure gestionis* contract claims. The abuse claim against U.S. creditors would be that U.S. creditors already had the emergency laws declared ineffective in U.S. courts. Bringing the claim to ICSID alleging that Argentina made use of its *iure imperii* powers to tamper with their contractual rights seems abusive since investors would be allowed to exploit enforcement possibilities not enjoyed in domestic lawsuits.

addition, any *ex ante* analysis must remain vague since every Tribunal will have to decide on the case specific measures.

As a preliminary point, it should be noted that while ICSID Tribunals will not judge on the monetary policy of the insolvent state (such as an abandonment of a currency peg), they will not be willing to accept a "general measures of economic policy" objection in order to sustain debt moratoria: Tribunals have "jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor …"[76]

One overriding question that will determine any analysis of specific treatment obligations will be whether account shall be taken of the circumstances under which a state adopted the challenged measures, as constantly raised by Argentine in the current ICSID proceedings.[77] In the alternative, the Tribunal would disregard the state's motivation and merely assess the effects of the emergency measures on investments, regarding the circumstances only on the "defences" stage.

1. Expropriation

The "circumstances-question" is currently debated in the context of expropriation and has given rise to diverging ICSID decisions.[78] An outright repudiation of sovereign debt would certainly be a clear case of direct expropriation which, in the absence of prompt, effective and adequate compensation, is a BIT violation.[79] The more intricate question is whether emergency measures could constitute a creeping or indirect expropriation The NAFTA-*Metalclad* decision suggested that a deprivation of reasonable to be expected economic benefit constitutes an indirect expropriation.[80] Presumably, the Tribunal, both in and outside the state insolvency context, would require a certain degree of interference with this reasonable-to-be-expected benefit.[81] A legislative fiat that stretches the maturity date of certain debt instrument to a limited extent could be acceptable while changing maturity for a significant

76 *CMS v. Argentina (Decision on Objections to Jurisdiction)*, Case No. ARB/01/8, 42 I.L.M. 799 (2003), para. 33 (emphasis added).

77 *CMS v. Argentina (Application for Annulment)*, 8 Sept. 2005, paras. 19-23, http://ita.law.uvic.ca/documents/cmsannulmentapplication.pdf.

78 *Kunoy*, Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration, 6 J. World Investment & Trade, 467, 469-472 (2005).

79 *Wälde*, supra note 2, 409. Argentine bondholders state that the recent Argentine law adopted in the aftermath of the June-2005 restructuring actually constitutes such repudiation, see *White & Case*, Recent Argentine Legislation and Bondholder Remedies, Memorandum to the Global Committee of Argentine Bondholders, 3. http://www.gcab.org/images/GCAB_ICSID_Postion_Paper_2-15-05.pdf.

80 *Metalclad v. Mexico(Award)*, Case No. ARB(AF)/97/1, 40 I.L.M. 35 (2001), para. 103.

81 There are diverging decisions on whether the degree of interference matters, *Kunoy*, supra note 78, 485-487.

time (i.e. from 5 to 30 years) could be viewed differently. It is to be noted that the CMS decision of May 2005 is of little avail in our context as it has to be seen in the specific minority-shareholder setting.[82]

2. Fair and Equitable Treatment

Although the discussion on what fair and equitable treatment means is still controversial, recent ICSID jurisprudence strongly relies on the legitimate expectations of the investor at the time of the investment decision.[83] In *CMS*, the Tribunal held that the conversion of dollar based claims to a local currency "*entirely transform[ed] and alter[ed]*" the business environment of the investment and thus violated the fair and equitable treatment standard.[84] A Tribunal would thus have to determine which investor expectations are actually so material to be covered by this "*entirely alter and transform the legal and business environment*-test". This could be tricky an exercise because on international securities markets, the legal features of debt instruments minutiously affect the price investors are willing to pay. One could make the argument that all characteristics of a debt security have an influence on the investment decision and are therefore material. A more narrow interpretation could regard as material only some key financial terms of a debt instrument, such as currency, maturity or, as the case may be, collateral features.[85]

3. Transfer Rights

Other treatment obligations of interest are provisions whereby states grant investors the right to freely transfer any received payment into a freely convertible, stable currency.[86] These guarantees, which trump the states' rights to adopt capital export control laws under Art. VI (3) of the IMF Agreement,[87] could be raised in a case like the Russian restructuring where ruble-payments were made into blocked accounts

82 *Schill*, From Calvo to CMS: Burying an International Law Legacy, SchiedsVZ 2005, 285, 289-290.

83 *Dolzer*, Fair and Equitable Treatment: A Key Standard in Investment Terms, 39 Int'l L. 87 (2005).

84 *CMS v. Argentina (Award)*, supra note 60, para. 275.

85 *I.e.* when a state undertakes to use certain revenues exclusively for debt servicing purposes and later removes this collateral feature by unilateral legislative action.

86 *Inter alia* see U.S. Model BIT Nov. 2004, supra note 43, Art. 7.

87 *Reinisch*, State Responsibility for Debts, 1995, 101. In *Hood Corp. v. The Islamic Republic of Iran et. al.*, the Iran-U.S. Claims Tribunal had the chance to rule on the relationship between the IMF Articles of Agreement, 22 July 1944, 2 U.N.T.S. 124, as amended through 28 June 1990, and the Iran-U.S. Treaty of Amity which contained a transfer guarantee similar to the BIT provisions. The Tribunal held the Treaty of Amity inapplicable on other grounds, see *Aldrich,* The Jurisprudence of the Iran-United States Claims Tribunal, 1996, 393.

that did not allow the investors to withdraw the funds and exchange them into dollars.

4. Umbrella Clauses

Even if umbrella clauses are not interpreted to elevate every contractual claim to a treaty claim,[88] they can still have a significant impact on a state's ability to adopt measures in situations of financial distress. In fact, a respective BIT clause could be interpreted to prohibit a state to adopt any *iure imperi* measures that would affect debt contracts held by foreigners. Umbrella clauses could thereby have the effect of a stabilization clause, a curious result as debt contracts hardly ever contain stabilization clauses.[89] Such an interpretation would render false the long standing perception that with respect to domestic law debt, the debtor state is free to change the law to adapt it to its public policy needs. It would be interesting to see markets reaction if an ICSID Tribunal in fact gives umbrella clauses so broad a meaning, because generally, the debtor state's (perceived) law making powers make domestic law debt much more risky, yielding much higher risk returns.[90] A more narrow interpretation would subject the umbrella clause to a public policy exemption to the benefit of the debtor state.

5. Non Discrimination, National Treatment and MFN

Last but certainly not least, the treatment obligations of national treatment, MFN and non-discrimination could play a major role in state insolvency cases under BITs. Inter-creditor equity has always been the fundamental concern for creditors.[91] At the outset it has to be noted that these provisions can become relevant for both "intergrationist" and "disintegrationist" Tribunals.

Generally speaking, the major task for Tribunals would be to assess whether or not an alleged unequal treatment occurred among similarly situated investors, a concept known to investment law[92] and state insolvency "law"[93] as well. This would

88 See supra III. 2.

89 *Siebel*, supra note 14, 190.

90 Argentina recently called off a domestic law bond launch because investors demanded too high a risk premium, see *Bloomberg News*, Argentina Cancels Bond Sale, Won't Pay 8.8% Yield, 21 Sept. 2005, http://www.bloomberg.com/apps/news?pid=email_us&refer=news_index&sid=ak3QHaN1eXLk.

91 Historically, discrimination based on the nationality of creditors has been a cause for diplomatic intervention by the investors' home governments, *Borchard*, supra note 9, 260-266.

92 *CMS v. Argentina (Award),* supra note 60, para. 293. *Wälde*, supra note 2, 411-414, stressing the parallel to the "like-products" problems in WTO law.

93 *Clark*, supra note 50.

surely require the state to treat holders of identical debt instruments identically. A highly political issue in this regard is whether a state is entitled to grant domestic creditors, such as domestic banks, better restructuring terms (or even entirely save them restructuring) compared to foreign creditors holding the same debt instruments. While *de jure* this looks like a clear-cut violation of national treatment commitments,[94] at least an economic case can be made for treating local creditors on a preferential basis.[95] Besides the national treatment question, BIT-MFN-obligations outlaw playing favourites among foreign creditors for political reasons. Where creditors are not holding identical debt instruments, the Tribunal would have to develop its own criteria to assess which groups of creditors are similarly situated and thus have to receive equal treatment. While developing these criteria could sometimes be burdensome (such as the question of whether or not a state is justified in paying multilateral institutions ahead of private foreign lenders),[96] at least some situations seem straightforward. *Inter alia,* trade creditors and bondholders are not similarly situated, a fact acknowledged by major creditor organizations.[97] Through a sophisticated classification of creditors, ICSID could help the state regain a stable current account and maintain basic services provided by foreigners (by allowing the state to pay *inter alia* foreign providers of airport security services).

Again, much of the outcome will depend on whether the circumstances of the crisis and public policy considerations will be considered for an examination of the treatment obligation assessment or only for possible defences.

V. Sovereign Defences

1. Acceptance of Majority Restructurings

As it is most likely that potential ICSID claimants would be holdout creditors (who are not participating in a voluntary debt swap), it is worth examining whether a sovereign could raise a defence that ICSID should not interfere with majority restructurings, i.e. where a (qualified) majority of creditors has accepted a restructuring plan. Such an objection, which would presumably be more prominent with "in-

94 In the Russian restructuring in 1998, local banks received significant secret side payments not made to foreign creditors, see *Sturzenegger*, Default Episodes in the 90s: Factbook, Toolkit and Preliminary Lessons, June 2003, 23, http://www.utdt.edu/~fsturzen/pinto2.pdf.

95 *Roubini*, Why Should Foreign Creditors of Argentina Take a Greater Hit/Haircut than the Domestic Ones?, 14 Dec. 2001 (First Draft), 4, http://pages.stern.nyu.edu/~nroubini/papers/discriminationforeigndebt.doc.

96 See *Martha*, Preferred Creditor Status under International Law: The case of the International Monetary Fund, 39 ICLQ 801-826 (1990).

97 *Institute for International Finance*, Principles for Stable Capital Flows and Fair Debt Restructurings in Emerging Markets, 31 March 2005, 14, www.iif.com/data/public/principles_final_0305.pdf.

tegrationist Tribunals", was envisaged by financial experts during the negotiations for the MAI.[98] But while there is no question that ICSID should give effect to a majority restructuring under CACs,[99] it is doubtable whether ICSID Tribunals can do the same in the absence of CACs, i.e. where the holdouts hold on to their old, unchanged debt claims. Annex G of the 2004 U.S.-Uruguay BIT actually has this effect, barring investor claims where creditors representing 75% of outstanding debt have accepted a restructuring offer, regardless of whether the original debt instruments allow for a majority restructuring or not.[100] The same approach was envisaged by the SDRM.[101] This might be a desirable result to enable more orderly debt restructurings and prevent a "rush to ICSID". However, there is no legal foundation for ICSID to uphold such a defence absent a clear treaty provision to that effect. The U.S.-Uruguay BIT and the IMF's SDRM proposal can certainly not be seen as evidence of a new customary international law rule that can limit BIT obligations.

2. State of Necessity and Debt Sustainability

A question common to those familiar with the current Argentina proceedings is whether a state in a situation of financial distress can invoke a State of Necessity, based on both BIT- and customary international law, to excuse BIT violations.[102]

A preliminary objection to such a defence was that BITs are intended to bite in times of economic difficulty and that the BITs' object and purpose exclude a State of Necessity defence (*Notstandsfestigkeit)*. The CMS Tribunal seems to embrace such an objection, stating that only in a situation of total collapse could a State of Necessity defence be raised The Argentine crisis, although being severe, would not qualify as a situation of total collapse.[103] Nonetheless, the Tribunal engaged in a (sometimes poorly argued)[104] substantive discussion of both Art. 25 of the 2001 I.L.C. Draft on State Responsibility[105] and the emergency clause Art. XI of the U.S.-Argentina BIT. I will briefly reproduce this discussion, highlighting some state insolvency specific questions that have not yet arisen in the pending proceedings.

The first prong a Tribunal has to assess when faced with a creditor claim against an insolvent state is whether a state is facing a *grave and imminent peril for an es-*

98 *OECD*, supra note 58, 23.
99 See supra II. 2. After a CAC restructuring, a creditor is only entitled to receive the restructured amounts. These restructurings thereby automatically affect claims under umbrella clauses.
100 Supra note 39, 54.
101 *IMF*, supra note 3, 26.
102 As to other possible public international law defences see *Leyendecker*, Auslandsverschuldung und Völkerrecht, 1988, 150-240.
103 *CMS v. Argentina (Award)*, supra note 60, para. 354-356.
104 *Schill*, supra note 82, 291.
105 As adopted by the U.N. General Assembly Resolution 56/83, 12 Dec. 2001, Official Records of the General Assembly, 56th Sess., Suppl. No. 10 (A/56/10).

sential interest when paying the claimant. Any definitive answer to this question would presumably require an assessment of the country's debt sustainability, the notion developed by the IMF that (in the IMF's view) justifies a sovereign debt restructuring.[106] The major problem here lies in the fact that states, invoking their fiscal and monetary sovereignty, fiercely oppose a legally binding determination of their debt sustainability by an international body. Consequently, the SDRM would have lacked the power to assess the debt sustainability of a country.[107] By contrast, in international law, as applied by the CMS-Tribunal, Necessity is not a self-judging concept.[108] Accordingly, an ICSID Tribunal has to make its own assessment of the Necessity/debt sustainability situation in a two step analysis: What are the foreign exchange reserves of the state? And what exactly are the recognizable essential interests (the *beneficium competentiae*) of a state that are protected by the State of Necessity notion? Arguably, ICSID Tribunals lack the resources to engage in such an analysis, so using more capable authority would be appropriate. Unfortunately, at least in the Argentina case, the IMF constantly refused to state whether, in its opinion, Argentina is unable or only unwilling to pay.[109] A related problem would be how to treat a creditor that only sues for a small amount, the payment of which cannot be said to cause a grave and imminent peril.[110]

Another crucial element of the State of Necessity test is whether the contested measure is *the only way* for the state to remedy the situation of necessity, Art. 25 (1) (a) I.L.C. Draft. The CMS-Tribunal is very (too?) restrictive on that point, leaving the state practically no discretion on how to react in an emergency situation.[111] It goes without saying that every individual state insolvency situation would warrant a case-specific analysis.

Lastly, the delicate question of contribution (a state cannot invoke Necessity where it has itself contributed to the situation of Necessity, Art. 25 (2) (b) I.L.C. Draft) could eliminate any State of Necessity defence in the state insolvency context. Of course the state has contributed to its debt burden when it voluntarily tapped capital markets. The CMS-Tribunal indicates that this could in fact be the end of the story, basically restricting the State of Necessity to cases of purely external in-

106 *IMF*, supra note 3, 22.

107 *IMF*, supra note 3, 28. In general see *Gianviti*, The Prevention and Resolution of International Financial Crisis: A Perspective from the International Monetary Fund, in *Giovanoli* (ed.), International Monetary Law – Issues for the New Millennium, 2000, 97, 108.

108 *CMS v. Argentina (Award),* supra note 60, paras. 373-374. ICJ, *Case Concerning the Gabcíkovo-Nagymaros Project*, ICJ Rep. 1997, 7, 40 with references to the work of the I.L.C.

109 *Gelpern*, After Argentina, Policy Briefs in International Economics, IIE Paper No. PB05-2, Sept. 2005, 5, http://www.iie.com/publications/pb/pb05-2.pdf.

110 See *Pfeiffer*, Zahlungskrisen ausländischer Staaten im deutschen und internationalen Rechtsverkehr, 102 ZVglRWiss 141, 163-164 (2003), promoting an examination of the overall debt situation (Gesamtbetrachtung).

111 *CMS v. Argentina (Award),* supra note 60, paras. 323-324. As to the criticism see *Schill*, supra note 82, 291; *CMS v. Argentina (Annulment Application),* supra note 77, paras. 81-82.

fluences.[112] Whether or not this restrictive interpretation will stand remains for the Annulment Committee to decide.[113]

D. Procedural Questions

After this analysis of the substantive treaty obligations, let me now turn to two procedural aspects that will be relevant in proceedings against an insolvent sovereign.

I. Stay of Proceedings During Restructuring Negotiations

In the discussions on the SDRM, the IMF insisted on a stay of court (enforcement) proceedings during ongoing restructuring negotiations in order to prevent obstructive creditor behaviour.[114] While U.S. courts have occasionally granted temporary stays,[115] Tribunals do not have the authority to stay proceedings until the end of restructuring negotiations, once the waiting period usually stipulated in BITs has lapsed.[116] Under current ICSID Rules, stays from enforcement are only permissible pending Interpretation, Revision and Annulment Proceedings, Art. 50-52 ICSID Convention.[117] To allow for a stay of proceedings pending restructuring negotiations, the Administrative Council would have to amend the Arbitration Rules under Art. 6 (1) (c) of the Convention.

II. Enforcing Creditor Claims and Diplomatic Protection

We have already come across the possibility of enforcement of ICSID awards on some occasions. Enforcement issues have so far rarely arisen because states gene-

112 *CMS v. Argentine (Award),* supra note 60, para. 329. *Schill*, supra note 82, 291. This deprives Art. 25 of any relevance. Cases "beyond the control of the state" are governed by Art. 23 (*Force Majeure*) I.L.C. Draft.

113 *See CMS v. Argentina (Annulment Application)*, supra note 77, paras. 83-84.

114 *IMF*, supra note 3, 25 (subjecting a stay to the approval of a 75% creditor majority).

115 *Pravin Banker Assocs. v. Banco Popular del Peru and the Republic of Peru*, 1994 U.S. Dist. LEXIS 2003, 23-33 (S.D.N.Y. 24 Feb. 1994). *Lightwater Corp. v. Argentina*, 2003 U.S. Dist. LEXIS 16868 (S.D.N.Y. 29 Aug. 2003, stay of execution). *Allied Bank International et. al. v. Banco Credito Agricola de Cartago et. al.* 733 F2d 23, 27 (2nd Cir. 1984). *Skeel*, Why Contracts are Saving Sovereign Bankruptcy, Int'l Fin. L. Rev. March 2006, 23, sums up the efforts as "mixed results".

116 Even these requirements could be rendered obsolete by virtue of MFN Clauses, see *Siemens v. Argentina (Decision on Jurisdiction)*, Case No. ARB/02/8, 44 I.L.M. 137 (Jan. 2005), paras. 79-109.

117 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, 575 U.N.T.S. 159 (hereinafter the Convention).

rally pay their ICSID awards.[118] However, the Argentine case suggests that this perception is invalid in state insolvency cases,[119] even though states clearly are under an international law obligation to comply with ICSID awards, Art. 53 (1) ICSID Convention. Hence, execution becomes a material concern for creditors, debtors and the entire ICSID system alike.

Enforcement is governed by Art. 54, 55 ICSID-Convention. Any contracting state is under an obligation to enforce an ICSID award as if it were a final judgment in that state, Art. 54 (1). The enforcement procedure is subject to the laws concerning execution of judgments in the state where enforcement is sought, without prejudice to local laws on immunity from enforcement, Art. 54 (3), 55. By virtue of this latter limitation, the traditional obstacles to execution outside of the debtor state's territory will also play out in the ICSID context. The restrictive immunity from enforcement theory (as predominantly applied among ICSID member states), as well as international law on diplomatic immunities, will prevent creditors from attaching assets of the diplomatic mission and other assets used for *iure imperii* purposes.[120] Although this causes inconveniences for the debtor state by impeding its commercial activities abroad, commercial assets will in most cases not be available for the creditor outside the debtor's territory.

One (perceived) advantage of Investment Treaty Arbitration from an investor's point of view is that, compared to domestic court judgments, ICSID awards can be enforced easier in the debtor state itself, at least in theory.[121] ICSID awards have the status of a final judgment of the debtor state's courts and must not be subjected to a public policy review by local enforcement authorities, clearly constituting an improvement compared to the enforcement of foreign court judgments and arbitral awards.[122]. A local court is by international law obliged to enforce an ICSID award without testing it against local emergency laws. Although the reference to local enforcement laws in Art. 54 (3) cannot introduce a public policy review through the backdoor,[123] it mitigates the advantages of ICSID proceedings. The debtor state is

118 *Schwarcz,* Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach, 85 Cornell L. Rev. 959, 1028 (2000).

119 *Alfaro/Lorenti*, The Growing Opposition if Argentina to ICSID Arbitral Tribunals, 6 J. World Investment & Trade, 417-430.

120 See supra II. 3. As to the immunity from attachment of diplomatic assets, see Vienna Convention on Diplomatic Relations, 18 April 1961, 550 U.N.T.S. 95, Art. 22 (3).

121 *Griffin/Farren*, How ICSID can protect sovereign bondholders, Int'l Fin. L. Rev. Sept. 2005, 21, 23.

122 See The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958, 330 U.N.T.S. 38, Art. V. For *exquatur* proceedings, see *Baars/Böckel*, supra note 33, 463.

123 *Schreuer*, The ICSID Convention – A Commentary, 2001, Art. 54 para. 104. Argentine attempts to that effect, see *Alfaro/Lorenti*, Argentina: The Enforcement Process of the ICSID Awards, Mondaq Business Briefing, 1 June 2005, www.mondaq.com, gravely err on that point of law.

free to invoke its own laws on immunity from enforcement to evade execution, and these local enforcement laws themselves are not subject to ICSID review.[124]

A more real enforcement prospect brings us to the more traditional sphere of international law, that of diplomatic protection. Failure of the debtor state to comply with an award (or a local judge striking down an award on local public policy grounds) triggers the state's international responsibility and can give rise to diplomatic protection of the creditors' home states, Art. 27 Convention, including taking the case to the ICJ, see also Art. 64 Convention.[125] Even more effective sanctions to compel the debtor state to pay could be exerted by ICSID's parent institution, the World Bank, as well as the latter's Bretton Woods twin, the IMF. U.S. lawyers have already pointed at the Helms Amendment under which the U.S. government is by law prohibited from making financial contributions to a country that repudiates or nullifies contracts with a U.S. person. This prohibition, which would presumably cover a default on ICSID awards, includes contributions through the IMF and the World Bank.[126] Given U.S. voting power in the Bretton Woods institutions, the Helms Amendment could be a very powerful tool in the creditors' hands.

Tribunals should have these political and diplomatic consequences in mind when deciding on the substantive issues outlined above, especially when creditors already have obtained judgments in local courts and have recourse to ICSID merely for the better enforcement prospects.

E. Conclusion

I. How Could State Insolvency Change Investment Treaty Arbitration?

In our analysis, we have seen some key challenges ICSID Tribunals will face when confronted with the phenomenon of state insolvency. The first challenge, both in procedural and substantive terms, is that the potential number of claimants (who are

124 *Schreuer*, supra note 123, Art. 55 para. 99, emphasizes that ICSID drafters contemplated withdrawing immunity under the laws of the host state but abandoned that idea. Many states have immunized their domestic assets from enforcement, *Wood*, Project Finance, Subordinated Debt and State Loans, 1995, 154.

125 A case before the ICJ under Art. 64 ICSID seems straightforward where the state does not pay the award. The debtor state could claim that it is simply unable to honour its obligation under Art. 53 (1) ICSID because it lacks sufficient funds, see *Lowe,* Some Comments on Procedural Weaknesses in International Law, 98 Am. Soc'y Int'l L. Proc. 37, 39 (2004) on Argentina's situation. The ICJ might engage in an analysis under Art. 61, 62 Vienna Convention on the Law of Treaties, thus further fragmenting international law.

126 22 U.S.C.S. § 2370a. See *Maiden,* Argentina Ruling Calls Halt to Holdout Litigation, Int'l Fin. L. Rev. June 2005, 6, 7. The Helms Amendment was already employed by an American investor to stop payments by the Inter-American-Development Bank to Costa Rica as long as Costa Rica did not accept ICSID Arbitration, *Compañía del Desarrollo de Santa Elena S.A. v. Costa Rica (Final Award)*, Case No. ARB/96/1, 15 ICSID Rev. – F.I.L.J. 169, paras. 24 ff. (2000).

everything but a homogenous group) largely exceeds that known from prior ICSID proceedings. Moreover, state insolvency raises some known substantive investment treaty questions in a new context, such as the State of Necessity/debt sustainability problem. Other issues such as the extraterritoriality issue are entirely new and reflect the structural differences between classic FDI and sovereign debt.

Undoubtedly, the sticking point to predict the outcome and the very nature of state insolvency proceedings in Investment Treaty Arbitration lies in the distinction between contract claims and treaty claims. Tribunal consistency on this issue is of fundamental importance for states and creditors. If the integrationist view prevails, and every sovereign default constitutes a BIT violation, ICSID could become very prominent a forum for an insolvent sovereign's creditors.

II. How Could ICISD Change the "Law" of State Insolvency

How then does Investment Treaty Arbitration have the potential to change the "law" of state insolvency? One instance where BITs and ICSID can have a significant impact is domestic law debt. If the monetary and exchange control laws of the debtor state are tested against the state's BIT obligations, investors' risk awareness towards domestic law debt could wane, especially if umbrella clauses are given the effect of stabilization clauses (see supra III. 4. d.). More importantly, Investment Treaty Arbitration, if enforced through the Helms Amendment, could significantly change multilateral emergency lending. If ICSID Tribunals rule in favour of holdout creditors, and if the Helms Amendment applies, the IMF and the World Bank would be barred from issuing emergency packages beyond its current policies that allow for lending into arrears under certain circumstances.[127] This could mean a significant shift in bargaining power during sovereign debt restructuring negotiations.

The future of sovereign debt workouts seems to lie in CACs that can mitigate the collective action problems. Investment Treaty Arbitration is not likely to tamper with CAC restructurings.[128]

127 *Salmon*, Sovereign Finally Closes Debt Restructuring, Euromoney July 2005, 42, 43. For the IMF, see *IMF*, Fund Policy on Lending into Arrears – Further Considerations on the Good Faith Criterion, 30 July 2002, 5.

128 We have so far overlooked majority enforcement clauses often used in trust indentures under U.K. law and becoming more prominent in New York law debt. Under these clauses, the initiation of lawsuits in domestic courts requires approval by 25% of the represented outstanding principal, see *Drage/Hovaguimian,* supra note 18, 5. How, under these circumstances, an "integrationist" Tribunal will react if a minority bondholder sues individually invoking an umbrella clause would be interesting to observe.

III. Would ICSID Make a Good SDRM?

In light of the preceding analysis, how can Investment Treaty Arbitration under ICSID (a World Bank institution after all) be reconciled with the ambitious IMF proposal for an SDRM? Could ICSID perform functions of such a body where support for an institutionalized SDRM is lacking? Or would ICSID Arbitration actually run counter to the general SDRM principles identified by the IMF? It is obvious that Investment Treaty Arbitration cannot function as a full-fledged SDRM The IMF heavily borrowed from national insolvency proceedings when designing its SDRM. ICSID Tribunals are not – without amendment of the Convention – intended to perform administrative functions of a national insolvency court. ICSID Tribunals are certainly not a forum where a distressed sovereign could file for bankruptcy (i.e. initiate a debt restructuring). As outlined above, ICSID would not even have the procedural competence to suspend holdout proceedings to await restructuring negotiations (supra IV. 1.), let alone certify a restructuring plan like a national insolvency judge would.

However, the IMF proposal also introduced a Dispute Resolution Forum (DRF) for creditor/debtor disputes that in fact relied on ICSID as a role model, though primarily for procedural matters.[129] Whether or not ICSID could perform functions of the (rejected) DRF will heavily depend on ICSID's self perception, especially with regard to the contract /treaty claims distinction. The DRF was designed as a "contract" forum that could *inter alia* rule on the validity of individual creditor claims. "Integrationist" Tribunals will face many of the substantive issues discussed in the SDRM context. The above analysis has shown that ICSID Arbitration and the SDRM principles are not always congruent. This firstly goes for the scope of ICSID Arbitration, which would include domestic law debt but would exclude nationals of the debtor state, contrary to the proposed DRF.[130] More significantly, under ICSID, a majority restructuring would not bind holdout creditors, a key feature of the SDRM. The same goes for a stay on creditor enforcement actions. Lastly, if the CMS decision stands, ICSID would have to make an autonomous assessment of the state's debt sustainability, which the DRF was expressly prohibited from doing.[131] A thorough interpretation of the BIT principles of national treatment, MFN and non

129 *IMF*, The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations, 27 Nov. 2002, 63, 69, http://www.imf.org/external/np/pdr/sdrm/2002/112702.pdf. See *Schwarcz*, supra note 118, 1024-1030.

130 *IMF*, supra note 3, 23.

131 *Id.*, 28

discrimination could, however, contribute to enhanced inter-creditor equity (supra III. 4. e.).

State Insolvency – Consequences and Obligations under Investment Treaties

Comment by *Peter Gnam*[*]

A.

From time to time there are situations also on the economic as well as political platform where "it takes two to tango". Facing insolvency and making efforts to get along with it could very well be such a "tango situation". The debtor makes short and long strides in all directions, but not getting away that much from those eager to dance with him, cheek to cheek, so as to get as much feeling as possible for the debtor´s movements and for what is left of the body to represent an asset which is worth dancing for it. Well, tango is popular in a way, but not everybody likes to dance it, in particular if the dancing part of the debtor is acted by a state, and if there are too many creditors bound to dance this kind of tango on a too small dancing floor.

B.

Mr. *Szodruch* has already thoroughly dealt with issues arising from portfolio investment under a sovereign debt default scenario. So I would like to focus my comments on the more traditional Foreign Direct Investment and its potential risk exposure in case of a state insolvency.

Bilateral Investment Treaties (BIT) are designed to support national companies (or even individuals) of one state who want to invest in the other contracting state by safeguarding as much as possible a predictable and reliable legal framework for such investment; this way an investor should be encouraged but also promoted to make direct investments into countries which are in need of them but lack the financial and/or technical capabilities to do it on their own. The purpose of any such Treaty is expressed in its respective Title and Preamble and is "to protect" and "to promote" investments.

BITs are not specifically designed to protect and promote sovereign bondholders, be it individuals or classes of them. We have learned from the paper presented by Mr. *Szodruch* whether and under which criteria they can qualify for being treated as "investors", and that it needs a little bit of doing to get the sovereign bondholders

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into and under the protection scheme of a BIT and onto the Investment Treaty Arbitration road.

As opposed to Foreign Investors, sovereign bondholders - under the respective terms and conditions for the emission of the bonds - a priori have a direct financial claim on repayment of the bond and interest; when they want to make use of a BIT and its possible arbitration clause, they do it to get an enforceable award on such repayment and thus to improve their chances for its execution. A Foreign Investor does not necessarily have financial claims against a state from the outset; but he has a claim that the state complies with all and any non-financial and legal commitments it has undertaken so as to make the investment feasible and its implementation safeguarded. Only in case the state does not meet any such commitment, the BIT appears on the scene so as to verify whether there is a breach of the BIT, and whether this breach has lead to a damage to the investor which then may or may not constitute a claim for money (compensation of damages) against the state in default under the BIT. However, such claim, when raised under a BIT, does not per se qualify to be added to the "debt pool" of a state insolvency and to give the claiming investor the position of a creditor in such insolvency. There is still a long way to go, if the state does not acknowledge such claim from the outset, which he normally does not.

Before we have a look into the practice of Foreign Direct Investment, a last observation in this context: it appears that the purpose of a BIT as outlined before and the purpose of whatever structure or procedure used for solving a state insolvency, do not match; they even seem to be contra-rotating. As there cannot be a liquidation of the state and its public assets, all concepts for solving a state insolvency are in the end directed to protect the state against its creditors (as opposed to the protection of an investor under a BIT); the creditors – so as to have a workable balance towards the needs of the state and the welfare of its citizens – are required to contribute to a solution of the "crisis" by e.g. writing off substantial parts of their financial claims. As for the foreign investors, the "encourage and protect investment–doctrine" of a BIT is turned upside down, and there is not much legal aid left to avoid the partial or total sacrifice of the investment.

Foreign Direct Investment mainly comprises large scale projects. In most cases, the investment is invited by a state to build up or strengthen its public service sector in the fields of energy or water supply network, oil and gas production, transport systems, telecommunication and IT infrastructure, but also to provide medical centers, hotel and resort complexes and the like. The investment required for such projects is mostly of substantial magnitude – and the state doesn´t have the money to spend on it, although being very often badly in need of accomplishing such projects.

In the last 2 or 3 decades, there very seldom have been, if at all, investment projects for which the state had to directly pay money to an investor. Foreign Direct Investment does in principle not create a creditor–debtor relation between the investor and the state per se or require it – at least as far as debt of money is concerned. These projects are either financed in the classic way through institutional or private lending – the state hereby becoming a financial debtor to the lenders, not to the investor – or through one of the tools of private project financing ranging from sup-

plier´s credit to BOT models or business outsourcing; in the latter cases, the investor assumes the advance obligation to have the project (or his participation in a privatized company) financed by his own resources or financing instruments, and he gets his "Return of and on Investment" from his participation in whole or in part in the proceeds of the project as a going concern.

Under a Foreign Direct Investment scenario, the role of the state is therefore not based on assuming payment obligations but is to establish and uphold stable, reliable and predictable investment conditions for the investment it is calling in, particularly in the administrative and legal environment. So the obligation of the state towards an investor is more an immaterial one, without a genuine financial debt exposure. The state by granting (non financial) guarantees, authorizations or licenses, or by creating specific administrative or legal infrastructures, safeguards an environment in which the project as a going concern shall be protected and can so pay back the investment by itself – and by e.g. paying taxes can even positively contribute to the state´s liquid assets.

One certainly can say that a state insolvency situation as such does not affect any such non financial commitments undertaken by the state. So it should not come as a surprise when I tell you, that the factor insolvency of a state – as a potential or given situation – is not and, as far as I know, never has been a relevant factor in any risk assessment an investor makes, before engaging in a cross border investment; honestly spoken: the management in charge of any such project und its legal advisors don´t even think about it.

It is the BIT which an investor becomes aware of and wants to call in, if and when there is a non fulfillment of a state´s commitments towards an investment or otherwise a violation of Treaty standards. And it is a default of the state in this respect which can substantially change the investor´s role towards the state: the investor, having so long been a "beneficiary" of the state under the investment protection scheme, mutates into a "creditor" of the same state, provided he suffers a damage and has the ius standi to present a financial claim under the Investment Treaty Arbitration scheme; and in case, after 3 to 5 years of arbitration proceeding, there is an enforceable award, favorable to the investor, the foreign investor from this moment on, and not earlier, can join the bandwagon of all the other financial creditors to the state and enjoy facing the realities of the actual debt situation of the state, an insolvency being imminent, already pending or not.

From a practical point of view, for the investor there is not much timing or even strategy available when and how to structure an Investment Treaty Arbitration along a state insolvency. Apart from the fact that one can not predict whether the insolvency of a state is of long term or rather short term nature, whether it occurs at the beginning of an arbitration proceeding, in the middle of it or thereafter, there is not much control on orientating the enforceability of an award to a certain stage of a state´s financial indebtedness. On the other hand, the investor needs an enforceable award anyway and this as soon as possible, so as to rank properly among other financial creditors, if need be.

In this context, I do not see much value in a discussion whether to establish rules on a "stay" for Investment Treaty Arbitration proceedings as long as an insolvency of the defendant state is pending or in a critical stage. An investor is somewhat lost in an insolvency as long as his claim is neither acknowledged by the state nor yet awarded by a tribunal and enforceable. The mere fact that there might still come up the one or other potential enforceable claim against a state in the distant future cannot have any impact on the need to solve an existing insolvency situation in the interest of the state itself and the well-being of its nationals but also in the interest of the financial creditors. A different aspect could be the question of having an "automatic stay" of enforcement of awards once there actually is a state insolvency. But this is neither a question under a BIT nor under the ICSID Rules, as an automatic stay had to apply to all creditors and would therefore require a statutory regulation under the insolvency procedure itself.

Argentina´s insolvency is over, for the time being; it was a fairly short one, if it has been one at all. One should not forget, however, that there still is an avalanche of 30 or more Investment Treaty claims pending at ICSID against this state with a claim exposure probably exceeding 20 billions of USD. I leave it open whether this can lead to another dangerous indebtedness potential of this state, in case all these claims succeed and become enforceable awards. I leave it open because Argentina is going to develop a strategy to bar such claims from becoming a real threat to the state. Argentina intends to run all ICSID awards, when rendered against it, through the annulment procedure. A "catch all" annulment scenario as defense against a new indebtedness potential - that is something new, apart from having the effect of blocking ICSID arbitration to some extent. But what is worse, from a legal point of view, is the strong political and legal opposition to ICSID arbitration as such (invoking inter alia the *Calvo* doctrine again) and the motion of certain members of the Government, to prevent enforcement of ICSID awards; it is alleged that both the BITs and the system of ICSID arbitration itself could violate the Argentine constitution and that therefore any award rendered thereunder could be declared null and void by a domestic court. Should the Government really dare to invoke such nullity in the future, it would block investors, for many years to come, to have a valid and enforceable financial claim and become a "creditor" to the state. This might also give the politicians of BIT states some headache as it can have consequences on future BIT negotiations or prolongations and the value of Investment Treaty Arbitration.

C.

So much for the reality of consequences and obligations under Investment Treaties in practice. The problem for a foreign investor is not the insolvency as such; the problem seems to be rather the bumpy road an investor has to go to acquire the legal qualification to present his financial claim in a state insolvency, whenever this might happen. Just to close the circle: the foreign investor has a bad dancing card and the

state is a lousy dancer when it is about to take the dancing floor to dance the “tango bancarotta”.

State Insolvency – Consequences and Obligations under Investment Treaties

Comment by *August Reinisch*[*]

After the fascination and comprehensive *tour de horizon* on State insolvency issues and ICSID we have just heard by Mr. *Szodruch* I would like to focus on one particular aspect and that is the question whether ICSID, this highly attractive forum for a particular type of international economic disputes, i.e. investment disputes, would also make a good sovereign debt restructuring mechanism (SDRM). In fact, mainly in the sovereign debt debate, ICSID has been mentioned time and again as a potential insolvency forum.[1] Whether this may have been motivated by its affiliation with the World Bank or because of a general feeling of its over-all success is not always clear. It is interesting, however, that the ICSID community, if I may thus call arbitrators, counsel and academics working in and writing on that field of investment law, has largely ignored, if not outright rejected, this potential role. ICSID tribunals like the one in the *CMS* case[2] have expressly rejected a general competence to adjudicate on general economic policy measures such as debt moratoria. According to the *CMS* Tribunal, they do "not have jurisdiction over measures of general economic policy adopted by [States] and cannot pass judgment on whether they are right or wrong." Instead, its jurisdiction was narrowly construed "to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[3]

This is all the more surprising, given the ever increasing scope of ICSID jurisdiction and thus its potential also for creditor claims against sovereign debtors.

Mr *Szodruch* has skillfully outlined the possibilities of ICSID in this regard and I agree with almost everything he says there. Still, as a commentator I feel a certain need, not necessarily to disagree or criticize, but at least to emphasize that there might be some considerable jurisdictional obstacles both *de lege lata* and *de lege ferenda* left.

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1 See *S. L. Schwarcz*, Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach, 85 *Cornell L.R.* 101 (2000).

2 *CMS* v. *Argentina,* Decision on Jurisdiction of 17 July 2003, Case No. ARB/01/8, 42 ILM 799 (2003).

3 *CMS* v. *Argentina, supra* note 2, para. 33.

Let me first turn to the question of *ratione materiae* jurisdiction of ICSID panels over loan and other debt claims. It is said in the paper that the "traditionally broad investment definition of Art. 25 ICSID encompasses loans and bonds, whether issued by private or public entities"[4], while it might be more questionable whether sovereign debt would always be covered by BIT definitions of investment.[5] Indeed, some BITs contain rather restrictive language with regard to the definition of investment which implies that the usual forms of sovereign debt would not be protected.

However, I would submit that it is still also a genuine ICSID issue whether sovereign debt always falls under the *ratione materiae* jurisdiction of Article 25 of the ICSID Convention. It is true that, in particular, *Fedax*[6] is a strong precedent and supports the proposition that all sovereign debt should qualify as investment under the Convention. Nevertheless, if we follow the, by now well-established, practice of ICSID tribunals to require, in addition to qualifying under the investment definition of the applicable BIT, fulfillment of the Article 25 ICSID Convention criteria of "investment", as they have been elaborated in legal doctrine[7] and by the case-law of the tribunals,[8] I am not so sure whether duration, risk sharing, substantial commitment, etc. are all fulfilled in all cases involving sovereign debt. There are many short-term debt instruments with fixed interest rates which may escape the investment notion under the ICSID Convention.

Szodruch has rightly reminded us that also the issue of *ratione personae* jurisdiction may provide some problems for the use of ICSID as a forum to settle sovereign debt disputes. The requirement that the private creditor has to have the nationality of a State party to the ICSID Convention and, since ICSID clauses are practically non-existent in bond or loan agreements, also of a BIT-partner of the debtor State may lead to rather fortuitous results. This is only exacerbated by the fact that most modern debt instruments are constantly publicly traded on the international financial markets which will make the precise holders of debt claims at a specific point in time sometimes hard to ascertain. The suggestion that MFN clauses could mitigate the problem that debt claims might have to be treated differently, always according to the applicable BIT between the sovereign debtor and the (national) groups of creditors,[9] would not solve the fundamental problem that some creditors may not have any access to investment arbitration at all because there is no

4 *Szodruch*, p. 148.
5 *Idid*., p. 149.
6 *Fedax* v. *Venezuela*, ICSID Case No. ARB/96/3, ICSID Decision on Jurisdiction of 11 July 1997, 37 ILM 1378 (1998).
7 According to *Schreuer*, The ICSID Convention: A Commentary (2001), 140, the typical features an investment would normally exhibit are a certain duration, a certain regularity of profit and return, an element of risk for both sides, a substantial commitment and a significance for the host State's development.
8 See *Joy Mining Machinery Limited* v. *Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction of 6 August 2004, 44 ILM 73 (2005), para. 53.
9 *Szodruch*, p. 151.

BIT in force. In addition, apart from a State's private creditors, an entire group, i.e. its public creditors, is necessarily left outside the venue of ICSID, whose *ratione personae* jurisdiction can only extend over "a Contracting State [...] and a national of another Contracting State"[10]. This contrasts with today's practice of debt relief in the form of restructuring and rescheduling of a State's (public and private) external debt, mainly achieved in the so-called Paris and London Clubs. ICSID could cover only private debt in this terminology, i.e. debts vis-à-vis private creditors who must be regarded as investors in order to qualify as potential users of the ICSID system. Admittedly, during the last 20 years public debt has become less important in relative terms compared to the recent surge of public financing through bond emissions. Still, the problem remains that ICSID could not "adjudicate" the claims of public creditors. This necessarily narrow jurisdictional scope of ICSID must be regarded as an inherent disadvantage for its potential use as an insolvency mechanism which is true not only *de lege lata*, but also *de lege ferenda*.

Let me thus now turn to the core policy issue relating to the question whether it would be feasible for ICSID to perform functions of a SDRM, i.e. restructuring the (private and public) external debt of sovereign States, and what kind of changes would be required for that purpose. The main task of a SDRM is the effective restructuring of a sovereign's debt enabling it to continue to operate and guaranteeing equal treatment to creditors. This requires compulsory jurisdiction over all creditors. ICSID, however, has just "random" jurisdiction over some creditors who seek to enforce their individual claims. There is no jurisdictional mechanism of forcing potential claimants to institute ICSID proceedings if they prefer not to sue or to sue elsewhere, as they are regularly entitled to under the dispute settlement clauses typically included in BITs. But even if all creditors chose to institute ICSID proceedings there is no compulsory consolidation mechanism which would guarantee a consistent outcome. Instead, parallel proceedings would result, with all the concomitant risks of conflicting or inconsistent outcomes, etc. To transform ICSID into a genuine SDRM with compulsory jurisdiction over all creditors of sovereign debtors by amending the ICSID Convention would be theoretically possible. There is, however, not only no indication of any political will to do so, it would also fundamentally change ICSID which has just started to establish a reputation as a well-functioning dispute settlement system for investment claims.

Instead of changing ICSID, one could consider other functions possibly performed by the Centre. Conceivably, the role of ICSID in situations of sovereign insolvency could be one of validating the existence of claims in first line. An effective SDRM would additionally require a forum competent to reduce the creditors' valid claims to a certain equal proportion and at the same time to achieve a debt discharge for the debtor State. Whether this central SDRM task could be performed

10 Article 25(1) ICSID Convention.

by the IMF or by a new international judicial or quasi-judicial body will be seen, but most likely it will not be ICSID.

Third-Party Participation (NGO's and Private Persons) and Transparency in ICSID Proceedings

Carl-Sebastian Zoellner[*]

A. Introduction

"Taking Stock After 40 Years," the title and purpose of the present conference, already suggests that at least de facto, there has to be a certain degree of transparency as regards the object of our scholarly attention – otherwise any stocktaking attempt would have to remain purely speculative and prove to be virtually impossible for all but those participants, among them my commentators, who have personally contributed to the emerging body of international investment law by sitting as arbitrators or by representing parties. Yet the question remains, to what extent, and on what basis, third-party participation and transparency have been incorporated in ICSID proceedings – and what the future perspectives of those concepts are.

When the International Centre for Settlement of Investment Disputes (ICSID) was created by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Convention),[1] some of its most important features represented clear and significant new developments in the realm of international law.[2] Third-party participation and transparency, however, do not fall squarely into this category: As far as procedure and organization are concerned, international investment dispute settlement in general has borrowed its main elements from the system of (private) commercial arbitration,[3] with ICSID being no exception to this rule. Compared to judicial proceedings before courts of law, commercial arbitration is generally characterized by significantly higher degrees of confidentiality and

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1 575 U.N.T.S. 159. The Convention was opened for signature in 1965 and came into force on 14 October, 1966.

2 Cf. *Lauterpacht*, Foreword, in: *Schreuer*, The ICSID Convention: A Commentary, xi (2001), who inter alia mentions the right of non-State entities to sue States directly, restrictions to State immunity, and the exclusion of the local remedies rule.

3 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 2, available at: http://www.oecd.org/investment.

privacy, by closed doors and often unpublished awards.[4] Accordingly, allowing parties to keep private the details of their dispute is routinely being viewed as one of the factors that give arbitration an advantage over court procedures.[5] This opacity not only appeals to private enterprises which fear exposure of business secrets, but scholars have also identified it as key reason why governments accept mixed arbitration in the first place.[6]

With regard to purely commercial arbitration agreed on between privates, deciding a case *in camera* without registration of the dispute or publication of the final award indeed does not offend fundamental principles of justice,[7] nor does it as such involve questions of democratic legitimacy.[8] Given the public policy implications of investor-state arbitration, where the proverbial "non-accountable three private individuals" scrutinize regulatory measures taken by legitimate governments, however, this might be very different for the kind of disputes ICSID has successfully administered in the last 40 years.[9] Therefore, in the context of international investment disputes, knowledge – implying the use of specialized *amicus curiae* expertise – and the accountability provided by publicity become key issues complementing confi-

4 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169 (*Weiler* ed., 2005); *Leahy/Bianchi*, The Changing Face of International Arbitration, 17(4) J. Int'l Arb. 19, 51 (2000); *Prütting*, Vertraulichkeit in der Schiedsgerichtsbarkeit und in der Mediation, in: Law of International Business and Dispute Settlement in the 21st Century – Liber Amicorum *Karl-Heinz Böckstiegel*, 629 (*R. Briner* et al. eds., 2002); *Lew*, The case for publication of arbitration awards, in: The Art of Arbitration – Liber Amicorum *Pieter Sanders*, 223, 224 et seq. (*Schultsz* ed., 1982). Privacy is concerned with limiting the rights of third parties (i.e. persons other than the arbitrators, the parties and possibly witnesses) to attend meetings, hearings and to generally know about or participate in the arbitration, while confidentiality refers to the obligation of arbitrators and the parties not to divulge information relating to the contents of the proceedings, relevant documents or the award itself. See *Lew*, Expert Report of Dr. *Julian D.M. Lew* in *Esso/BHP v. Plowman*, 11(3) Arb. Int'l 285 (1995).

5 Cf. *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 138 (2003); *Merkin*, Arbitration Law 1 (1991).

6 See, for instance, as regards states's acceptance of arbitration before the International Chamber of Commerce in Paris, *Böckstiegel*, Arbitration of Disputes between States and Private Enterprises, 59 Am. J. Int'l L. 579, 584 (1965).

7 Cf. *Blackaby*, Public Interest and Investment Treaty Arbitration, Paper delivered at ASA Swiss Arbitration Association Conference on Investment Treaties and Arbitration in Zurich (25 January 2002), reprinted in 1 Transnat'l Dispute Management (2004), available at: http://www.transnational-dispute-management.com/.

8 But see *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 135 (2003).

9 It should be noted, however, that of more than 120 cases submitted to ICSID, the vast majority were only submitted in the past few years – a trend indicating further dramatic increases in the future, see *Flores*, Energy and International Law: Development, Litigation, and Regulation, 36 Tex. Int'l L. J. 1, 8-9 (2001); *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1538 *et seq.* (2005) with further references.

dentiality and privacy.[10] To properly reconcile and balance these at times conflicting principles is the task an effective and legitimate institutional framework for investment dispute settlement needs to achieve. How does ICSID fare in this respect?

In order to answer this question, I will first of all introduce the various dimensions of transparency and briefly outline its history in international economic law (B.). Having set the analytical framework, I will turn to the development and current state of third-party participation and transparency in investment disputes administered under ICSID rules, comparing it to other investment dispute settlement mechanisms where appropriate (C.). Building up on recent changes ignited by the ICSID Secretariat Draft Proposal, I will then discuss benefits and potential costs of transparency in investor-state arbitration and evaluate the present developments against this background (D.).

B. Transparency in International Economic Law

I. The Notion of Transparency

In a recent article, transparency has been described as "egregiously overused and poorly understood buzzword."[11] Indeed, when looking at international law at large, it becomes apparent that not many terms refer to situations as different from each other as "transparency" does. First of all, transparency has gained considerable importance in the study of international relations. Given the fundamental structural changes in the international legal order, i.e., with a view to the notable shift from Westphalian sovereignty to an international law of cooperation and integration, states today face more and more obligations stemming from a rapidly growing number of international law instruments.[12] Transparency has been identified as key concept to ensure compliance with these obligations.[13] Because this paradigmatic shift arguably entails the partial transfer of sovereignty and previously national competences to international regimes, transparency also increasingly becomes subject of

10 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 170 (*Weiler* ed., 2005).

11 *Hale/Slaughter*, Transparency: Possibilities and Limits, 30 Fletcher F. World Aff. 153, 163 (2006).

12 *Delbrück*, Structural Changes in the International System and its Legal Order: International Law in the Era of Globalization, 11 Schweizerische Zeitschrift für Internationales und Europäisches Recht 1 (2001), *passim*.

13 See *Chayes/Handler Chayes*, The New Sovereignty 135-53 (1995); *Hansen*, Transparency, Standards of Review, and the Use of Trade Measures to Protect the Global Environment, 39 Va. J. Int'l L. 1017, 1060 (1999).

debates circulating around the democratic legitimacy of this phenomenon.[14] Furthermore, on the international, regional and national level alike, additional aspects of transparency currently enjoy high attention and are constantly gaining importance in the respective legal regimes.[15] Thus, generally speaking, the current discussion of transparency in international law can be grouped along three different contexts: (1) as a concept underlying obligations international law places on states' internal legal regimes and procedures;[16] (2) as a concept governing the relations between institutions and regimes of international law and (their) member states;[17] and (3) as a concept denoting the openness of institutions and procedures of international law, especially *vis-à-vis* international civil society.[18]

As far as the narrower field of international economic law is concerned, however, the notion of transparency is predominantly used in the last sense, i.e., to express criticism regarding the way agreements are negotiated, institutions are governed or dispute settlement operates – it is the very absence, the proverbial "lack of transparency" and the allegedly resulting legitimacy or democratic deficit which dominate

14 *Petersmann*, Time for a United Nations 'Global Compact' for Integrating Human Rights into the Law of Worldwide Organizations: Lessons from European Integration, 13 Eur. J. Int'l L. 621, 646 (2002); *Delbrück*, Exercising Public Authority Beyond the State: Transnational Democracy and/or Alternative Legitimation Strategies*?*, 10 Ind. J. Global Leg. Stud. 29, 42 (2003).

15 On the international level, for instance, transparency is currently at the center of the debate regarding the problem of corruption,. *Ouzounov*, Facing the Challenge: Corruption, State Capture and the Role of Multinational Business, 37 J. Marshall L. Rev. 1181, 1198 (2004); *Klich*, Bribery in Economics in Transition: The Foreign Corrupt Practices Act, 32 Stan. J. Int'l L. 121 (1996). On the regional and national level, the transparency principle is increasingly reflected in a right for citizens to access information, cf. *Riemann*, Die Transparenz der Europäischen Union: das neue Recht auf Zugang zu Dokumenten von Parlament, Rat und Kommission, *passim* (2004). But see *Bradley Pack*, FOIA Frustation: Access to Government Documents under the Bush Administration, 46 Ariz. L. Rev. 815 (2004).

16 *Zoellner*, Transparency. An Analysis of an Evolving Fundamental Principle of International Economic Law, 27 Mich. J. Int'l L. 579, 582 et seq. (2006); cf. also United Nations, Conference on Trade and Development, Transparency, Series on Issues in International Investment Agreements, UNCTAD/ITE/IIE/2003/4, 16 et seq. (2004), available at: http://www.unctad.org/en/docs/iteiit20034_en.pdf; *Hilf*, Power, Rules and Principles - Which Orientation for WTO/GATT Law?, 4 J. Int'l Econ. L. 111, 119 (2001).

17 *Mitchell*, Sources of Transparency: Information Systems in International Regimes, 42 Int'l Stud. Q. 109, 110 et seq. (1998); *Aceves*, Institutionalist Theory and International Legal Scholarship, 12 Am. U.J. Int'l L. & Pol'y 227, 250-51 (1997); see also *Abbott*, "Trust But Verify": The Production of Information in Arms Control Treaties and Other International Agreements, 26 Cornell Int'l L. J. 1, 40-45 (1993).

18 *Alvarez*, Hegemonic International Law Revisited, 97 Am. J. Int'l. L. 873, 876 et seq. (2003); *Stein*, International Integration and Democracy: No Love at First Sight, 95 Am. J. Int'l. L. 489, 493 (2001); cf. also *Long*, „Democratizing" Globalization: Practicing the Policies of Cultural Inclusion, 10 Cardozo J. Int'l & Comp. L. 217, 259 et seq. (2002).

the discourse over transparency in this field of law.[19] Focusing in further on investment dispute settlement, these concerns have not only aggravated civil society groups,[20] but they have also been voiced by officials working for the US State Department: "Conducting arbitrations implicating the public interest in conditions of secrecy is unacceptable."[21] Yet until the beginning of 1981, information relating to ICSID proceedings was not available to the public at all.[22] Thus, it becomes evident that the awareness of transparency and its role in state-investor arbitration has only evolved slowly.

II. Historic Development of Transparency in International Economic Law

While there is no historical study on the emergence of international norms on transparency and citizen participation, *Immanuel Kant*'s coining of the phrase "capacity for publicity" in his essay Perpetual Peace certainly comes to mind as a key moment.[23] According to *Kant*, the "transcendental formula of public right [requires that] all actions that affect the rights of other men are wrong if their maxim is not consistent with publicity."[24] A first intergovernmental step to provide for some transparency on the international level was Art. 18 of the Treaty of Versailles,[25] following President *Wilson*'s famous call for "open covenants of peace, openly arrived at" instead of secret diplomacy.[26] From the current perspective, this develop-

19 *Head*, Seven Deadly Sins: An Assessment of Criticisms Directed at the International Monetary Fund, 52 U. Kan. L. Rev. 521 (2004); *Lacarte*, Transparency, Public Debate, and Participation by NGOs in the WTO: A WTO Perspective, 7 J. Int'l Econ. L. 683, 686 (2004); *Waincymer*, Transparency of Dispute Settlement within the World Trade Organization, 24 Melb. U. L. Rev. 797 (2000); *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817 (1998).

20 *Atik*, Legitimacy, Transparency and NGO Participation in the NAFTA Chapter 11 Process, in: NAFTA – Investment Law and Arbitration 135, 149-150 with further references (*Weiler* ed., 2004); cf. also *Hober*, Arbitration Involving States 139, 151, in: Leading Arbitrator's Guide to International Arbitration (*Newman/Hill* eds., 2003).

21 *Barton Legum* (then Legal Advisor to the U.S. State Department), cited in: The American Lawyer, Feature, 1 March 2002.

22 *Delaume*, ICSID Arbitration: Practical Considerations, 1(2) J. Int'l Arb. 101 (1984).

23 *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 928 (2004).

24 *Kant*, Zum Ewigen Frieden, in: Werke, Bd. 6, 326 (*Toman* ed., 1995) (1789).

25 Art. 18 required that all treaties be registered and then published by the Secretariat of the League of Nations, and stipulated that no such treaty or agreement would be binding until registered. See Treaty of Peace Between the Allied and Associated Powers and Germany, 28 June 1919, in: The Treaties of Peace 1919-1923, Vol. 1.

26 The citation is from the first of Wilson's fourteen points, *Stavasage*, Open-Door or Closed-Door? Transparency in Domestic and International Bargaining, 58 International Organizazion 667, 668 (2004) with an account of transparency's increasing role in international negotiations following World War I.

ment may have provided the necessary intellectual stimulus for the emergence of transparency as an issue in international economic law.[27]

As regards substantive provisions in international economic law, however, the first fundamental norm dealing with transparency did not concern the publicity of dispute settlement but another dimension of transparency: The Convention Relating to the Simplification of Customs Formalities (Customs Convention) subjected member states to transparency disciplines by mandating the prompt publication of all customs regulations and "clear and most definite" public notice of the conditions for export and import licenses.[28] The Customs Convention was also remarkably modern insofar as it explicitly expanded the group of beneficiaries to "persons concerned," which did not only include state parties but also domestic persons as well as aliens,[29] and provided for dispute settlement.[30] Furthermore, and probably most noteworthy, private parties played a significant role in the negotiating and drafting process.[31] The International Chamber of Commerce, for instance, exerted considerable influence on the formation of policy on the subjects of publicity and redress.[32]

More specifically with regard to investment dispute settlement, however, transparency's role remained limited for a long time. Even today many Bilateral Investment Treaties (BITs) and multilateral instruments like the Energy Charter Treaty do not require investors to publicly manifest their intention to launch a dispute, nor do they provide for the publication of awards or openness of proceedings – public disclosure thus often depends on the arbitral rules chosen by the parties or, in the absence of any regulation, on the will of the parties.[33] In this respect, the default rule stemming from investor-state arbitration's origins in commercial arbitration seems to be that unless neither party objects to it, no publication takes place and the pro-

27 *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 929 (2004).

28 International Convention Relating to the Simplification of Customs Formalities, 3 November 1923, 19 Am. J. Int'l L. Supp. 146 (1925), at art. 3(a) and art. 4.

29 *Id.*, at art. 4 para. 1.

30 *Id.*, at art. 7 and art. 22.

31 This at least holds true for organizations representing the business community, *Ridgeway*, Merchants of Peace 204, 207-08, 211 et seq., 216, 232 (1938); *Charnovitz*, Transparency and Participation in the World Trade Organization, 56 Rutgers L. Rev. 927, 929 (2004).

32 *Ridgeway*, Merchants of Peace 213 (1938).

33 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment.

ceedings remain closed.[34] Notable exceptions to this *confidentiality* rule are the most recent versions of the US and Canadian Model BITs.[35] In a similar vein, most investment treaties regularly do not contain rules piercing the *privacy* of the proceedings, i.e., governing the admissibility of *amicus curiae* submissions.[36] Again, the current versions of the US and Canadian Model BITs are prominent deviations from a general phenomenon.[37] Given this wide-spread lacuna, however, arbitral rules and framework norms such as those contained in the Convention gain crucial importance as far as third party participation and transparency of proceedings are concerned: In the absence of transparency provisions in the applicable substantive law, the procedural norms of the arbitration facility determine the degree of openness in the respective proceedings.[38]

34 *Collins*, Privacy and Confidentiality in Arbitration Proceedings, 30 Tex. Int'l L.J. 121, 122 (1995); *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 172 (*Weiler* ed., 2005). Whether there really is a presumption of absolute confidentiality, however, is subject to debate and influenced by the legal traditions at the place of arbitration. See *Bagner*, Confidentiality - A Fundamental Principle in International Commercial Arbitration? 18(3) J. Int'l Arb. 243 (2001); *Leahy/Bianchi*, The Changing Face of International Arbitration, 17(4) J. Int'l Arb. 19, 36 (2000); *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 959 (2003);. *Buys*, The Tensions between Confidentiality and Transparency in International Arbitration, 14 Am. Rev. Int'l Arb. 121, 125 et seq. (2003). Cf. also *Ali Shipping Corp. v. Shipyard Trogir* [1998] 2 All ER136 with *Esso Australia Resources Ltd and Others v. Plowman (Minister for Energy and Minerals) and Others*, 128 ALR 391 (1995).

35 See US Model BIT 2004, at art. 29, available at: http://www.ustr.gov/assets/Trade_Sectors /Investment/Model_BIT/asset_upload_file847_6897.pdf; Canadian Model Agreement for Promotion and Protection of Investments (2004), art. 38, available at: http://www.naftaclaims. com/files/Canada_Model_BIT.pdf. At least with regard to the United States, this development was inter alia prompted by the domestic Freedom of Information Act (FOIA), cf. *Loewen Group, Inc. and Raymond Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3 (Award), 26 June 2003, available at: http://www.investmentclaims.com. In any event, the US and Canada were also the first to undertake opening up NAFTA arbitration proceedings they are involved in, with Mexico joining later. See NAFTA Free Trade Commission Joint Statement on the Decade of achievement (San Antonio, 16 July 2004)), reprinted in: *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 17, available at: http://www.oecd.org/investment.

36 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 183 (*Weiler* ed., 2005).

37 See US Model BIT 2004, at art. 28 para. 2, available at: http://www.ustr.gov/assets/Trade _Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf; Canadian Model Agreement for Promotion and Protection of Investments (2004), at art. 39, available at: http://www. naftaclaims.com/files/Canada_Model_BIT.pdf.

38 Generally, the level of confidentiality in arbitration proceedings will be determined both by the applicable arbitration rules as well as the arbitration law at the place of arbitration. In addition, Art. 44 of the Convention emphasizes that it remains at the discretion of the parties to deviate from the default frame provided by the ICSID arbitral rules.

C. Development and Current State of the Game

I will thus now turn to the law governing the administration of investment dispute settlement proceedings by ICSID as it has developed and currently stands. With a view to the very recent changes brought about by amendments to the Arbitration Rules the Administrative Council adopted pursuant to Art. 6 of the Convention on 10 April 2006 ((ICSID Arbitration Rules),[39] this section will first sketch the normative framework effective before the amendments, then elaborate on the changes originally suggested by the ICSID Secretariat as well as on the actual amendments.

I. Third-Party Rights and Transparency at Relevant Stages of ICSID Proceedings Before the Recent Amendments

First of all, factors implicating transparency and third-party rights at various stages of the proceedings will be analyzed, i.e., norms pertaining to the registration of disputes, access to hearings, right to submit documents, and access to awards and other relevant documents. Relevant provisions can be found in the Convention itself as well as in Administrative Regulations and in the ICSID Arbitration Rules 2003. Corresponding norms in the ICSID Additional Facility Rules 2003 shall also be included in the survey.[40]

1. Registration of Disputes

When ICSID is chosen as a arbitration facility, the ICSID secretariat routinely applies a policy of registering all cases and publishes the register on its website.[41] According to the pertinent regulation, this register includes the names of the involved parties, the date of registration and a short summary of the dispute.[42] Administrative Regulation 23 (2) further clarifies that the register is open for inspection

39 See ICSID's website, http://www.worldbank.org/icsid/basicdoc/basicdoc.htm, for regulations and rules currently in force. Furthermore, references to the corresponding norms and rules pertaining to conciliation proceedings administered by ICSID will be provided in the footnotes. The rules effective before the recent amendments (hereinafter: ICSID Arbitration Rules 2003) are still available at http://www.worldbank.org/icsid/basicdoc/basicdoc-2003.htm.

40 The ICSID Additional Facility Rules have been amended effective 10 April 2006 as well, however, the rules effective prior to these changes (hereinafter: ICSID Additional Facility Rules 2003) are still available at: http://www.worldbank.org/icsid/facility/facility-2003.htm.

41 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment.

42 See ICSID Administrative Regulation 22 (1), available at: http://www.worldbank.org/icsid/basicdoc/basicdoc.htm.

by any person.[43] Such a detailed public register guarantees at least a minimum degree of transparency concerning current investment disputes; in this regard, the policy applied by ICSID is a noteworthy contrast to that of other institutions, such as for instance the International Chamber of Commerce (ICC) or Stockholm Chamber of Commerce (SCC), which both do not publish precise information about registration, number or content of administered investor-state arbitration cases.[44] Furthermore, as regards non-institutional *ad hoc* arbitration, the most commonly used UNCITRAL rules do not feature a registration requirement, either.[45]

2. Access to Proceedings

Under this heading, two facets of transparency can be discussed: (1) "passive" access to the hearings, for instance by means of broadcast or physical attendance, and (2) "active" access, i.e., the right of third parties to participate in the proceedings by submitting amicus curiae briefs.

a) Privacy v. Open Proceedings

Neither the Convention nor the ICSID Arbitration Rules 2003 contained norms providing for open hearings or access to submissions and other relevant documents absent party consensus. To the contrary, Rule 32 (2) ICSID Arbitration Rules 2003 explicitly stipulated that it was only with the consent of the parties that the Tribunal could allow third parties, i.e., "other persons besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the

43 *Id*., at Regulation 23 (2).

44 Consequently, there is only "anecdotal evidence" about the exact number of investment arbitration cases administered by these facilities, and "no one" likely knows the precise number of UNCITRAL cases, see *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1541 n.75, n. 77 (2005). The ICC does, however, publish general statistics about the number of requests for arbitration in the ICC Arbitration Bulletin and indicates the percentage of proceedings in which at least one party has been a "state, parastatal or public entity." See also http://www.iccwbo.org/court/english/right_topics/stat_2005.asp.

45 UNCITRAL has a secretariat, however, the latter has no mandate to register cases or keep data of the use of its rules by investors. *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 3, available at: http://www.oecd.org/investment. It should also be noted that ICSID is increasingly offering administrative support in *ad hoc* arbitrations based on the UNICTRAL rules, see for instance recently the UPS case, *United Parcel Service of America v. Canada*, available at:http://www.investmentclaims.com.

Tribunal" to attend the hearings.[46] A similar rule had been included in the ICSID Additional Facility Rules 2003.[47] Given this univocal directive contained in the applicable rules, it was also clear that a Tribunal could not exercise its powers with respect to arbitral procedure to allow attendance by third parties against the will of the parties – they effectively enjoyed a veto right.[48] Finally, arbitrators had to sign a declaration that they "shall keep confidential all information coming to [their] knowledge as a result of [their] participation in the proceeding" before the respective tribunal can be constituted.[49]

Bearing in mind that the Convention explicitly leaves it up to the parties to decide on rules applicable in the proceedings,[50] however, it would have been nevertheless perfectly possible for the parties to agree on completely open proceedings both in conciliation as well as in arbitration cases brought before ICSID. Empirically, however, the necessary party consensus to open up ICSID proceedings or even publicly broadcast them has been missing – a stark contrast to a number of cases stemming from the investment Chapter 11 of the North American Free Trade Agreement (NAFTA)[51] which were decided under UNCITRAL rules.[52]

46 ICSID Arbitration Rules 2003, Rule 32(2), available at: http://www.worldbank.org/icsid /basicdoc/basicdoc-2003.htm. As to conciliation, the identical standard is laid down in Rule 27 (2) ICSID Conciliation Rules 2003. In addition, the rule's preceding paragraph holds that hearings shall take place in private and remain, unless the parties otherwise agree, secret.

47 See ICSID Additional Facility Rules 2003, Schedule B Art. 34 (1) and (2) (Conciliation), Schedule C Art. 39 (2) (Arbitration), available at: http://www.worldbank.org/icsid/facility/ facility-2003.htm. As to factfinding, Schedule A Art. 9 (4) lays down that sessions of the Commission "shall not be public."

48 For a recent confirmation of this state of affairs, see *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as Amicus Curiae (17 March 2006), para. 7, available at: http://www.worldbank.org/icsid/cases/ARB0317-AC-en.pdf (hereinafter*: Aguas Provinciales*); *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A., and Vivendi Universal, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae* (19 May 2005), para. 6, available at: http://www.investmentclaims.com (hereinafter*: Aguas Argentinas*).

49 ICSID Arbitration Rules 2003, Rule 6 (2); ICSID Additional Facility Rules 2003, Schedule C Art. 13 (2); cf. also ICSID Conciliation Rules 2003, Rule 6 (2); ICSID Additional Facility Rules 2003, Schedule B Art. 13 (2), available at: http://www.worldbank.org/icsid/basicdoc/ basicdoc-2003.htm and http://www.worldbank.org/icsid/facility/facility-2003.htm respectively.

50 See supra, note 39.

51 North American Free Trade Agreement, 17 December 1992, Can.-Mex.-U.S., 32 I.L.M. 289..

52 The pertinent NAFTA cases are UPS, supra note 46; *Methanex Corporation v. United States of America*, and *Canfor Corporation v. United States of America*, both available at http://www. investmentclaims.com.

b) Amicus Curiae Submissions

aa) Normative Framework

As far as the "active" access to proceedings is concerned, the general exclusion of third parties from the hearings was complemented by the fact that both the Convention and the ICSID Arbitration Rules 2003 did not arrange for submission of amicus curiae documents to tribunals; the relevant evidence rules were silent on this issue.[53] And again, until recently ICSID proceedings had not produced precedents comparable to NAFTA cases under UNCITRAL rules which confirmed that tribunals had broad authority to accept and consider submissions from third parties.[54] Because ICSID is one of the dispute settlement facilities investors may turn to in disputes arising under NAFTA,[55] however, this very well could have been different. In its 2003 interpretative note, the NAFTA Free Trade Commission (FTC) clarified that "no provision of [NAFTA] limits a Tribunal's discretion to accept written submissions from a person or entity that is not a disputing party."[56] Furthermore, Art. 44 of the Convention stipulates that "if any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question." Thus, if the admission of amicus curiae submissions were such a question of procedure, an ICSID tribunal would have been able to admit them even on the basis of the old rules, if it deemed the briefs to be helpful in justly deciding the dispute.

bb) Recent Jurisprudence: Aguas Argentinas and Aguas Provinciales

Such a reasoning has recently indeed been employed by the Tribunals in two ongoing arbitrations, *Aguas Argentinas* and *Aguas Provinciales*. In both cases, the state party agreed to allow amicus curiae submissions, whereas the claimant opposed such an opening up of the proceedings.[57] Acknowledging that neither the Convention nor the ICSID Arbitration Rules 2003 specifically authorized or prohibited the submis-

53 See ICSID Arbitration Rules 2003, Rules 33-37, available at: http://www.worldbank.org/icsid/basicdoc/basicdoc-2003.htm; ICSID Additional Facility Rules, Schedule C Rules 40-44, available at: http://www.worldbank.org/icsid/facility/facility-2003.htm.

54 *Amicus Curiae* submissions have been allowed in UPS and Methanex, cf. *Methanex Corporation v. United States of America*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "amici curiae", 15 January 2001.

55 NAFTA, supra note 52, at Art. 1120 Nr. 1 a).

56 *Free Trade Commission*, Statement on non-disputing party participation (October 2003), reprinted in: *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 15, available at: http://www.oecd.org/investment.

57 See *Aguas Argentinas*, supra note 49, para. 8, *Aguas Provinciales*, supra note 49, para. 9.

sion by non-parties of amicus curiae briefs while noting the absence of any precedent under ICSID Arbitration Rules 2003 granting this right, the Tribunals examined two questions: (1) Did they have the power to accept amicus curiae submissions? and (2), if they had, what were the conditions under which this right could be exercised?[58] Even though at least in Aguas Argentinas the claimant specifically argued that allowing amicus curiae submissions would effectively introduce additional parties to the dispute and thus yield substantive consequences,[59] the Tribunals in both cases held that given the traditional concept of acting as "friend of the court" and its application in other forums, the question of amicus curiae submissions merely concerned an offer of assistance to the court regarding expertise and perspectives the parties themselves could not provide.[60] Furthermore, the Tribunals found support for their conclusion that the permissibility of amicus curiae briefs was a procedural question by comparing Art. 44 of the Convention with Art. 15 (1) of the UNCITRAL rules, which had been the legal foundation for amicus curiae participation in Methanex, and by looking at the practice of other international arbitral proceedings in the practice of NAFTA, the Iran-United States Claims Tribunal, and the World Trade Organization.[61] In sum, because the Tribunals were also convinced they could exercise their discretion to accept third party briefs without putting an increased burden on only one of the parties, they held that Art. 44 of the Convention indeed granted Tribunals the power to accept amicus curiae submissions from suitable nonparties in appropriate cases.[62]

Having decided that as a general matter they had the power to accept such submissions, the Tribunals had to answer the second question and develop conditions under which they may exercise this right. Accordingly, in order to balance the interest of third parties to be heard with substantive and procedural rights of the disputing parties, they established three basic criteria: (1) the appropriateness of the subject matter of the case; (2) the suitability of the given nonparty in the specific case; and (3) the procedure by which the amicus curiae submission is made and considered.[63] The first criterion refers to the public interest of a dispute, understood as cases in which the decision have the potential to directly or indirectly affect persons other than the disputing parties,[64] whereas the suitability of a given nonparty prima-

58 *Aguas Argentinas*, supra note 49, para. 9; *Aguas Provinciales*, supra note 49, para. 10.

59 *Aguas Argentinas*, supra note 49, para. 12.

60 *Aguas Argentinas*, supra note 49, para. 13; *Aguas Provinciales*, supra note 49, para. 13.

61 *Aguas Argentinas*, supra note 49, paras. 14-15; *Aguas Provinciales*, supra note 49, paras. 14-15.

62 *Aguas Argentinas*, supra note 49, para. 16; *Aguas Provinciales*, supra note 49, para. 16.

63 *Aguas Argentinas*, supra note 49, para. 17; *Aguas Provinciales*, supra note 49, para. 17.

64 *Aguas Argentinas*, supra note 49, para. 19; *Aguas Provinciales*, supra note 49, para. 18. In this context, the Tribunal also noted that increasing transparency in proceedings implicating the public interest also increased the legitimacy of international arbitral processes in general and ICSID in particular, see *Aguas Argentinas*, supra note 49, para. 22; *Aguas Provinciales*, supra note 49, para. 21.

rily depends on its expertise, experience, and independence.[65] When deciding on an application for leave as amicus curiae, the Tribunals would consider the opinion of the parties, the additional burden on parties, Tribunal, and proceedings as well as the degree to which the proposed amicus curiae brief was likely to aid the Tribunal in arriving at its ultimate decision.[66]

3. Access to Awards

In contrast to the issue of amicus curiae briefs and its original drafts, the Convention and the ICSID Arbitration Rules 2003 are perfectly clear as far as the publication of awards is concerned: Most fundamentally, Art. 48 (5) of the Convention mandates that ICSID may not publish awards without the consent of the parties; Administrative Regulation 22 (2) reiterates this principle.[67] Rule 48 (4) ICSID Arbitration Rules 2003 slightly but importantly refined this prohibition by adding that excerpts of legal rules applied by the respective Tribunal may be published by the Centre.[68] This modification was included in the 1984 revision of the ICSID Arbitration Rules and can be interpreted as a reaction to parties selectively disclosing information about past proceedings.[69] ICSID actively seeks and, statistically, obtains the consent of the parties to publish the full award in the ICSID Review – Foreign Investment Law Journal or, more recently, though its website in about fifty per cent of the cases.[70] Because Art. 48 (5) of the Convention is addressed to ICSID only, however, the parties remain free to make awards available to the public unless they have agreed otherwise.[71] Consequently, even if one party does not consent to ICSID publishing

65 *Aguas Argentinas*, supra note 49¸para. 24; *Aguas Provinciales*, supra note 49, para. 23.

66 *Aguas Argentinas*, supra note 49, para. 27; *Aguas Provinciales*, supra note 49, para. 26.

67 ICSID Administrative Regulations, Regulation 22(2). While first drafts leading up to the Convention were silent on the question of publication, a later suggestion to authorize the ICSID to publish the award "except as the parties otherwise agree" was changed into the prohibition currently in force. See *Schreuer*, The ICSID Convention: A Commentary, Art. 48 mn. 95 (2001) with further references.

68 ICSID Arbitration Rules 2003, Rule 48(4), available at: http://worldbank.org/icsid/basicdoc/basicdoc-2003.htm; see also ICSID Additional Facility Rules 2003, Rule 53 (3), available at: http://www.worldbank.org/icsid/facility/facility-2003.htm which in addition allows the registration of awards if this is required by the arbitration law of the country where the award is made. In conciliation proceedings, ICSID has no authority to publish the report, cf. Art. 33 ICSID Conciliation Rules.

69 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 MN 96 (2001); implicitly recognizing the challenge to provide a "balanced" account when information about proceedings is disclosed by parties or their counsel *Lalive*, The First 'World Bank' Arbitration (Holiday Inns v. Morocco)-Some Legal Problems, 51 Brit. YB of Int'l L. 123, 132 n.1 (1980).

70 *Yannaca-Small*, Transparency and Third-Party Participation in Investor-State Dispute Settlement Procedures, OECD Working Paper No. 2005/1, 4, available at: http://www.oecd.org/investment.

71 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 MN 100 (2001).

the award, the other party frequently releases it for publication in the International Legal Materials or other avenues.[72] Taken together with ICSID's competence to publish excerpts of the legal rules applied, at least the key holdings of all ICSID awards nowadays are available to the public.[73]

4. Access to other Documents (Decisions, Memorials, Minutes)

Even though Art. 48 (5) of the Convention literally refers to awards only, ICSID has always handled other (interim) decisions a tribunal may take, such as preliminary decisions on jurisdiction (Art. 41), procedural orders or recommendations of provisional measures, congruently, and will thus not publish them without the consent of the parties.[74] As far as their pleadings and other information about pending proceedings are concerned, publication remains at the individual discretion of the parties, i.e., absent an agreement to refrain from disclosure, they may unilaterally do so.[75] Given that the rules are silent on this issue, the unilateral release of such information had been subject of a request for provisional measures, however, the Tribunal refused to recommend provisional measures barring the public discussion of the pending case by the investor.[76] Very recently, however, for the first time in ICSID history, both parties of a case consented to the publication of their pleadings by the ICSID Secretariat.[77] Finally, as to the keeping of minutes of all hearings, the current version of the Administrative Regulations clarifies that the Secretary-General may only arrange for publication if both parties consent.[78]

5. Conclusion

Notwithstanding some policies supporting transparency, notably in terms of registration of disputes and publication of at least legal excerpts of awards, confidentiality and privacy notions stemming from its conceptual origins in commercial arbitration have dominated state-investor dispute settlement administered by ICSID. This holds

72 See, for instance, *AAPL v. Sri Lanka*, Award, 27 June 1990, 30 I.L.M. 577 (1991); *AMT v. Zaire*, Award, 21 February 1997, 36 I.L.M. 1531 (1997); *Fedax v. Venezuela*, Decision on Jurisdiction, 11 July 1997, Award, 9 March 1998, 37 I.L.M. 1378, 1391 (1998).

73 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 182 (*Weiler* ed., 2005).

74 *Schreuer*, The ICSID Convention: A Commentary, Art. 48 mn. 105 (2001).

75 *Id.*, MN 107-111.

76 C. *Amco v. Indonesia*, Decision on Preliminary Measures, 9 December 1983, 1 ICSID Reports 410.

77 See ICSID, Documentation Regarding ICSID Case No. ARB/05/10, *Malaysian Historical Salvors v. Malaysia*, http://www.worldbank.org/icsid/cases/caseARB-05-10.htm.

78 ICSID Administrative Regulations, supra note 40, Regulation 22 (2) c).

particularly true as regards third party participation, which had not been envisioned by the normative ICSID framework at all. Considering the public policy implications of cases before mixed tribunals, this was a questionable state of affairs. Furthermore, it was also out of line with some of the more recent NAFTA cases brought under UNCITRAL rules and the underlying policy choices by the respective NAFTA member states which put an emphasis on transparency and third party participation.[79] Against this background, the fact that recently the Tribunals in Aguas Provinciales and Aguas Argentinas ruled they were competent to accept amicus curiae briefs even though one party opposed this step is all the more remarkable. As each award is only binding inter partes and cannot function as binding precedent on future Tribunals, however, Aguas Provinciales and Aguas Argentinas did not mitigate the general need for discussing potential reforms of the normative framework as such.

II. The ICSID Secretariat Draft Proposals

1. Discussion Paper

This need for discussion has also been recognized by the ICSID Secretariat: Reflecting on the practice of ICSID and responding to proposals made and concerns voiced by different parties, the ICSID Secretariat in 2004 issued a discussion paper on "Possible Improvements of the Framework for ICSID Arbitration."[80] In addition to topics such as interim relief, an increased role for mediation and the possible creation of an appeals facility, transparency and third party access to ICSID arbitral proceedings were raised as potential areas of improvement.[81] The ICSID Secretariat recognized that even though at least the key legal holdings of awards were eventually published under the then existing framework, requiring party consent for publication of the full award raises the issue of timeliness – oftentimes, several months pass before the Secretariat obtains consent of both parties.[82] Thus, speedy publication of the legal excerpts is all the more important. It therefore proposed to make timely publication of excerpts by the Secretariat mandatory.[83] Contrasting previous ICSID practice with the NAFTA cases mentioned above, the Secretariat moreover suggested amendments to the ICSID Arbitration Rules 2003 to clarify that – and under what conditions – panels have the authority to accept third party submissions

79 See NAFTA Free Trade Commission Joint Statement on the Decade of achievement, supra note 36.

80 ICSID Secretariat, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper, 22 October 2004, available at: http://www.worldbank.org/icsid/highlights/ DiscussionPaper.pdf.

81 Cf. *id.*, at para. 6.

82 *Id.*, at para. 12.

83 *Id.*

from, for instance, civil society organization, business groups, or other States parties to investment treaties concerned.[84]

2. Working Paper

Having received feedback from the members of the Administrative Council as well as from business and civil society groups, arbitration experts and institutions, the Secretariat finally in May 2005 presented a working paper including detailed suggestions how to amend the ICSID Arbitration Rules 2003 and Administrative Regulations.[85] Amending the rules and regulations only requires a majority of two-thirds of the members of the Administrative Council.[86] Although the proposals regarding access of third parties to the proceedings in particular elicited some disagreement, reactions to the preceding discussion paper had been generally positive.[87] Hence, it seemed most of the amendments suggested had a realistic chance to be realized.

a) Publication of Legal Excerpts

As far as transparency-related amendments are concerned, the ICSID Secretariat first of all suggested clarifying the wording of Rule 48 (4) ICSID Arbitration Rules 2003 to read: "The Centre shall, however, promptly include in its publications excerpts of the legal conclusions of the Tribunal."[88] Hence, this change aimed at introducing the qualifier "promptly" in the rule and making publication mandatory, thereby guaranteeing early release of such excerpts. A similar rule regarding the publication of full awards, however, is barred by Art. 48 (5) of the Convention and would thus require the unanimous decision of all contracting parties to amend the Convention.[89] This seems rather unlikely – in its discussion paper, the ICSID Secretariat itself noted that obtaining "unanimous ratification for an amendment by the 140 Contracting States would at best be a very long process."[90] Because it is applicable to arbitrations not governed by the Convention, however, a different situation

84 *Id.*, at para. 13.
85 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf.
86 See Art. 6 (1) of the Convention.
87 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf, para. 6.
88 *Id.*, 9. The corresponding art. 53 (3) of the ICSID Additional Facility Rules was to be changed accordingly.
89 See Art. 66 (1) of the Convention.
90 ICSID Secretariat, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper, 22 October 2004, para. 3, available at: http://www.worldbank.org/icsid/ highlights/DiscussionPaper.pdf.

arises with respect to Rule 53 (3) ICSID Additional Facility Rules 2003, which could very well be amended to indicate that, in cases of investment arbitration, awards shall be published by ICSID unless the parties agree otherwise.[91]

b) Access to Proceedings

In contrast to those pertaining to the publication of excerpts by the ICSID Secretariat, the proposed changes with regard to third party access to proceedings were more fundamental and the most controversial, for they would have drastically impacted the traditionally prominent role of party consensus in questions of procedure.[92] According to suggested amendments of Rule 32 ICSID Arbitration Rules 2003, allowing third parties to attend or observe parts or all of the hearings would have become a discretionary competence of the Tribunal.[93] While it would have had to consult "as far as possible" with the Secretary and the parties before exercising this competence, the final decision would have been vested with the Tribunal, which also would have had to establish appropriate procedures.[94] Moreover, the proposal undertook to fill the lacunae described above regarding amicus curiae submissions by amending Rule 37 ICSID Arbitration Rules 2003.[95] Analogous to the suggested competence as regards passive access, a new paragraph explicitly empowered the Tribunal to allow, "after consulting both parties as far as possible," third parties to file written submission with the tribunal. In accordance with the legal reasoning sketched above, the Secretariat described these latter amendments as clarification rather than as an expansion of the Tribunal's competences.[96] The proposed amendment obligated the Tribunal to consider, among other things, the extent to which (1) a potential third party's new insight, perspective or particular knowledge would aid the Tribunal in the determination of factual or legal issues; (2) the third party would address a matter within the scope of the dispute; and (3) the third party has a "significant interest in the proceedings."[97] Finally, the Tribunal would have to ensure

91 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev., 1521, 1602 (2005).

92 It is thus not entirely surprising that this part of the proposal has been "watered down" to safeguard a de facto veto of either party. See infra, part III.; cf. also *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/Itn_mar29_ 2006.pdf.

93 ICSID Secretariat, Suggested Changes to the ICSID Rules and Regulations, Working Paper, 12 May 2005, available at: http://www.worldbank.org/icsid/highlights/052405-sgmanual.pdf, 10. The corresponding Art. 39 (2) of the ICSID Additional Facility Rules was to be changed accordingly.

94 *Id.*

95 *Id.,* 11. Similar changes were suggested for ICSID Additional Facility Rules Art. 41.

96 *Id.*

97 *Id.*

that the submission would neither disrupt the proceedings nor unduly burden either party.[98]

III. The New ICSID Arbitration Rules

On 5 April 2006, ICSID issued a press release informing the public that voting by the members of the Administrative Council on "the amendments recently proposed by the Secretariat" had been concluded and that changes were expected to come into effect on 10 April 2006.[99] It is worth mentioning, however, that the final proposal actually voted upon differed in some key aspects from the previous versions of suggested reforms which had been tendered for public comment and that have been summarized above.[100] As a matter of fact, while voting on the amended proposals took place in late 2005 and early 2006, the text being voted upon was not released to the public at that time and has only recently been leaked – a few days before the official release of the adopted amendments.[101] In the context of changes intended to create a more transparent framework for improving the legitimacy and acceptance of the investor-state arbitration process, this may strike one as rather ironic.

Be that as it may, as far as substantive changes to the original ICSID Secretariat Draft Proposal are concerned, most notably the possibility for Tribunals to open up proceedings at their own discretion has been watered down significantly: Instead of leaving the decision after consulting "with the parties as far as possible" with the Tribunal, ICSID Arbitration Rule 32 (2) now features an introductory "Unless either party objects"-qualifier.[102] Therefore, parties still enjoy a de facto veto right, and accordingly, some commentators have already stated that this change between the old rules and the newly adopted ones was "hardly a big difference."[103] Indeed, the only difference seems to be that while before open hearings could only be instituted in case of an explicit consensus of the parties, it is now the absence of a veto that suffices, i.e., one could view the new system as one of an implicit "tacit consent" presumption. Nevertheless, effective party control of the privacy of hearings has been preserved by the member governments.

98 *Id.*

99 See ICSID News Release, Amendments to the ICSID Rules and Regulations (5 April 2006), available at: http://www.worldbank.org/icsid/highlights/03-04-06.htm.

100 See *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/itn_mar29_2006.pdf.

101 *Id*.

102 ICSID Arbitration Rules, Rule 32 (2), available at: http://worldbank.org/icsid/basicdoc/basic en.htm.

103 See *Vis-Dunbar/Peterson*, ICSID Member-Governments OK watered-down changes to arbitration process, IISD Investment Treaty Breaking News, 29 March 2006, available at: http://www.iisd.org/pdf/2006/itn_mar29_2006.pdf, quoting *Schreuer*.

With the exception of the nixed competence of the Tribunal to grant passive access even in case of party opposition, however, the other changes with transparency implications originally proposed the ICSID secretariat have been adopted. That is to say, the modification regarding the mandatory and prompt publication of legal excerpts by the ICSID Secretariat as well as the clarification that Tribunals may accept amicus curiae submission where deemed appropriate have been approved and came into effect on 10 April 2006.[104]

IV. Conclusion

In sum, the adopted amendments corroborate the reasoning employed by the Aguas Argentinas and Aguas Provinciales Tribunals as far as amicus curiae submissions are concerned. The additional changes originally proposed by the ICSID Secretariat would have further parlayed the role of transparency by leaving the new possibility to open up hearings, even in the face of opposition by the parties, at the discretion of the Tribunal. This being said, it should not be forgotten that with a view to Art. 44 of the Convention, the parties always remain free to agree on different rules which should govern the arbitration. In other words, if both parties would have agreed beforehand to exclude third parties from the hearings as well as from submitting briefs, a Tribunal could not have referred to the proposed amendments in the ICSID Arbitration Rules and decide otherwise. This caveat notwithstanding, the suggested changes nevertheless would have had a significant impact, for unlike under the old as well as under the newly adopted rules, consensus of both parties would have been necessary to have *closed* hearings – a polar opposite to the hitherto existing situation and quite likely the reason why member governments (for now) declined to actually adopt this change and instead opted to preserve an effective veto right.

D. Perspectives and Limits of Transparency

When looking at the most recent versions of prominent national model BITs, disclosure policies applied by NAFTA countries, and recent practice of investor-state arbitration Tribunals as summarized above, one could conclude that there currently is a general trend towards transparency in international investment arbitration.[105] The amendments originally suggested by ICSID Secretariat and, at least partially, the changes actually adopted pick up on this trend. Some interested parties, however, oppose these developments for a number of reasons, inter alia because they are

104 Cf. ICSID Arbitration Rules, Rules 48 (4) and 37 (2), available at: http://worldbank.org/icsid/basicdoc/basic-en.htm.

105 *Legum*, Trends and Challenges in Investor-State Arbitration, 19 Arbitration International 143, 144 (2003).

perceived as unduly interfering with the principle that party consensus forms the basis of arbitration proceedings.[106] In the following, I will thus weigh potential benefits and problems of increasing transparency and third party participation in investor-state arbitration and assess in how far the proposed and adopted ICSID Arbitration Rules respectively represent a good compromise between the competing interests.

I. Benefits of Transparency and Third Party Participation

1. Knowledge, Expertise and Coherence

Dating back as a concept to Roman times,[107] the classical reason for allowing non-disputant parties to file amicus curiae briefs is to inform the court about additional aspects of a case which are important, but have not been reflected in the parties' own submissions – be it because they lacked the necessary expertise,[108] be it because as a party, their individual interest in the outcome of the case did not accommodate ramifications of a claim that concern "the public interest,"[109] be it because they deliberately chose to.[110] Therefore, third party participation is primarily deemed to increase the information available to a tribunal, thereby leading to a better informed and thus ideally better quality decision.[111] Against this background, common law systems embracing the concept of amicus curiae have traditionally restricted third

106 See *South Centre*, Developments on Discussions for the Improvement of the Framework of for ICSID Arbitration and the Participation of Developing Countries, South Centre Analytical Note, para. 41, available at: http://www.southcentre.org/tadp_webpage/research_papers/investment_project/icsid_discpaper_feb05.doc.

107 See *Angell*, The Amicus Curiae Brief: American Development of English Institutions, 16 Int'l Comp. L.Q. 1017 (1967).

108 Due to the increasing complexity of scientific risk assessment, the tension between risk regulation and investment treaty disciplines might be an area in which governments could indeed lack the degree of expertise highly specialized NGOs or individual experts can provide. In a similar vein, disputes in the realm of the World Trade Organization (WTO) have been heavily influenced by party submissions which included studies provided by NGOs and academics, *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836 (1998).

109 *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 956 (2003).

110 For instance, in the context of investor-state arbitration, general political considerations or the fear to create unfavorable precedent undermining the government's position in another pending case might keep parties from including certain aspects of a case in their pleadings, cf. in the context of amicus curiae participation in the WTO, *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836-837 (1998).

111 Cf. regarding the WTO, *Charnovitz*, Participation of Nongovernmental Organisations in the World Trade Organization, 17 U. Pa. J. Int'l Econ. L. 331, 351 (1996).

party submissions to a strictly informative, as opposed to a more advocating role – a "friend" is not a party.[112]

Transparency has another important "knowledge" dimension: It is only with awards being published that the knowledge of legal interpretations of clauses typically contained in investment treaties leaves the confines of a secretive "network of law firms" involved in these proceedings.[113] General access to awards thus levels the playing field and provides every potential party and their legal counsel with a wider array of jurisprudence to litigate with.[114] Furthermore, a closely related positive effect of transparency provided by published awards lays in its contribution to a more coherent formulation of international investment law: Even though commentators have cautioned to limit expectations about outcome predictability and emphasized the peculiar nature of state-investor arbitration, which features highly fact dependent doctrines and can thus produce different results in seemingly similar cases,[115] it can hardly be denied that insofar it is possible, both parties and tribunals regularly refer to the legal reasoning employed by prior tribunals. Thus, notwithstanding the fact that arbitration awards strictly speaking cannot create binding precedent,[116] publishing the legal reasoning and application of relevant doctrines in awards nevertheless fosters at least a certain degree of predictability and coherence as far as the interpretation of similar obligations contained in investment protection instruments is concerned.[117]

This is a very welcome development, not only because it aids tribunals themselves to consider more fully the legal issues at hand and to, as the case may be, issue a rational distinction based on reasoned opinions.[118] Just as importantly, the resulting predictability is vital for the effective functioning of the respective investment treaties, which are geared towards "increasing substantially investment oppor-

112 Regarding this distinction and the different schools of thought in US jurisprudence, see generally *Ford*, What are „Friends" for ? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 236-240 (2005).

113 *Blackaby*, Public Interest and Investment Treaty Arbitration, Paper delivered at ASA Swiss Arbitration Association Conference on Investment Treaties and Arbitration in Zurich (25 January 2002), reprinted in 1 Transnat'l Dispute Management (2004), available at: http://www.transnational-dispute-management.com/.

114 *Id.*

115 *Coe*, Toward a Complementary Use of Conciliation in Investor-State Disputes -- A Preliminary Sketch, 12 U.C. Davis J. Int'l L. & Pol'y 7, 21-22 (2005).

116 An award is binding only on the parties to the dispute and does not give rise to stare decisis precedent regarding the interpretation of a given clause or rule. This principle has also been stressed by the tribunal interpreting Art. 15 (1) UNCITRAL Rules in *Methanex,* see *Methanex*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," 15 January 2001, para. 51.

117 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521, 1524, 1616-1617 (2005).

118 *Id.*, 1616.

tunities in the territories of the parties" by "ensuring a predictable commercial framework for business planning and investment."[119]

2. Legitimacy and Good Governance

While informing tribunals, counsels, parties and scholars as demonstrated is an important facet of transparency and third party participation, their public and scholarly discussion alike mostly center around the more prominent notions of democratic legitimacy, the "public interest" and good governance.[120] In fact, transparency has even been labeled "the most basic of good governance principles."[121] Why is this – and what does it mean for investment dispute settlement within the ICSID framework?

It is almost a truism by now that investor-state arbitration has the potential to significantly affect the "public interest."[122] This is not merely the case because one of the parties is a state,[123] however, it is due to the fact that the subject matter of many investment disputes impacts on the provision and costs of "public" services such as water, waste management, electricity or gas[124] or touches on the legality of domestic regulatory actions in sensitive fields such as environmental protection[125] and emer-

119 The quotes are taken from NAFTA's art. 102 para. 1 and preamble respectively, the underlying *telos,* however, is representative of any investment protection agreement. As to the economic investment incentives created by transparency, see generally *Zoellner*, Transparency. An Analysis of an Evolving Fundamental Principle of International Economic Law, part II.B.1, 27 Mich. J. Int'l L. 579, 587 (2006).

120 In this respect, see the often cited article by *DePalma*, NAFTA's Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say, N.Y. Times, 11 March 2001, Section 3, 1; cf. also *Ford*, What are „Friends" for ? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 209-211 (2005); *Soloway*, NAFTA's Chapter 11 - The Challenge of Private Party Participation, 16 J. Int'l Arb. 8, 10 (1999); *Gurudevan*, An Evaluation of Current Legitimacy-based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process, 6 San Diego Int'l L.J. 399, 425-427 (2005) with further references.

121 *Mann/Cosbey* et al., Comments on ICSID Discussion Paper "Possible Improvements of the Framework for ICSID Arbitration, International Institute for Sustainable Development (IISD), 8, available at: http://www.iisd.org/pdf/2004/investment_icsid_response .pdf.

122 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 220 (2001).

123 *Methanex Corp. v. U.S.*, Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," para. 49 (Jan. 15, 2001), available at: www.investmentclaims.com.

124 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 197 (*Weiler* ed., 2005).

125 *Hodges*, Where the Grass is Always Greener: Foreign Investor Actions Against Environmental Regulations Under NAFTA's Chapter 11, 14 Geo. Int'l L. Rev. 367, 385 (2001); cf. also *Wälde/Dow*, Treaties and Regulatory Risk in Infrastructure Investment, 34(2) J. World Trade 1, 17 (2000), generally discussing criticisms regarding binding international arbitration undermining domestic political processes and regulatory autonomy.

gency measures in times of severe economic plight.[126] Accordingly, these public interest implications create the need for public knowledge and, assuming that there was a general duty of confidentiality in arbitration, arguably for a public interest exception in investment dispute settlement cases.[127] By opening up proceedings to the public, publishing awards and allowing civil society's input by means of amicus curiae submissions, stakeholders will be more comfortable that their interests are being judged fairly and effectively.[128] Consequently, legitimacy and acceptance of binding investment arbitration processes, which offer claimants a uniquely strong "sword" compared to other international law instruments, will benefit.[129]

In terms of legitimacy and good governance, however, we should not focus too narrowly on the facilities and institutions of investor-state arbitration. To the contrary, from a good governance perspective, the legitimacy of involved governments depends at least as much on increased transparency in state-investor arbitrations as can be said with regard to the public acceptance of dispute settlement proceedings and Tribunals: As a prerequisite for accountability, transparency enables citizens to control the actions of their governments.[130] In the context of state-investor arbitration, this is significant for a number of reasons. For one, and most importantly, the public policy ramifications sketched above require from a democratic point of view that the position taken and the legal arguments made by governments in these pro-

126 Regarding the most notorious example of Argentina's pesification measures and resulting implications for ICSID arbitration and international investment law, see the contribution in this volume by *Szodruch*, State Insolvency – Consequences and Obligations under Investment Treaties; *Tietje*, Die Argentinien-Krise aus rechtlicher Sicht: Staatsanleihen und Staateninsolvenz, 37 Beiträge zum Transnationalen Wirtschaftsrecht 13-16 (2005).

127 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 221 (2001).

128 *Clark*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 852 (1998).

129 Regarding the connection between transparency and acceptance of investment arbitration, see *Methanex*, supra note 53, Decision of the Tribunal on Petitions from Third Persons to Intervene as "amici curiae", 15 January 2001, para. 49. Concerning the perception that investment treaties and awards have moved from providing a "protective shield" against government overreaching to granting investors a "sword" to cut into domestic public protection laws, see *Jones*, NAFTA Chapter 11 Investor-to-State Arbitration Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared? 2002 B.Y.U.L. Rev. 527, 528 (2002).

130 As to the relation between information provided by transparency and accountability, see generally *Reuben*, Mandatory Arbitration: Democracy and Dispute Resolution: The Problem of Arbitration, 67 Law & Contemp. Prob. 279, 289 (2004); *Delbrück*, Diskussionsbeitrag zum Referat Hilf, 40 Berichte der Deutschen Gesellschaft für Völkerrecht 386, 387 (2003); *Bluemel*, Overcoming NGO Accountability Concerns in International Governance, 31 Brooklyn J. Int'l L. 139, 144 (2005); *Dunn*, Situating Democratic Political Accountability, in: Democracy, Accountability, and Representation 329, 335 (*Przeworski et al*. eds., 1999).

ceedings be available to the electorate.[131] Thereby, a control mechanism as regards the negotiation, conclusion, administration and concrete effects of investment treaties is established; ideally, the populace can respond to unwelcome developments at the voting booth. The vast potential effects investment disputes can have on the public purse bolster the need for accountability in this respect.[132]

More specifically, transparency in arbitration proceedings can prevent capture and successful rent-seeking by special interests and functions to reveal a government's responsiveness to genuine domestic preferences and democratic majorities.[133] As a matter of fact, the "filter function" governments traditionally assumed in international economic law,[134] i.e., the denial of amicus curiae submissions and direct third party participation in favor of "indirect" representation via government submissions necessarily mandates that domestic interest groups have the possibility to check whether their concerns are adequately reflected in government submissions.

II. Costs and Potential Problems of Increased Transparency and Third Party Participation

Having seen the benefits transparency and third party participation have to offer, I will now turn to costs and potential problems associated with increasing the openness of investment dispute settlement proceedings.

First of all, it should be noted that the very concept of transparency is one that is nowadays common to many western countries, but not necessarily rooted in other societies.[135] In a similar vein, the concept of amicus curiae is generally well-known

131 *Keohane*, quoted after *Bluemel*, supra note 131, 144: "Accountability refers to relationships in which principals have the ability to demand answers from agents to questions about their proposed or past behavior, to discern that behavior, and to impose sanctions on agents in the event that they regard the behavior as unsatisfactory."

132 *Fracassi*, NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations, 2 Chi. J. Int'l L. 213, 220 (2001).

133 For a lucid discussion of the interconnectedness of transparency, accountability and the problem of capture using cost-benefit analysis, see *Hahn/Tetlock*, Using Information Markets to Improve Public Decision Making, 29 Harv. J.L. & Pub. Pol'y 213, 264 (2005).

134 *Debevoise*, Access to Documents and Panel and Appellate Body Sessions: Practice and Suggestions for Greater Transparency, 32 Int'l L. 817, 836 (1998); *Ullrich*, No Need for Secrecy?, 34 U.B.C. L. Rev. 55, 59-60 (2000).

135 *Morrisson*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 860 (1998). For a critical account of the WTO transparency disciplines and their impact on developing states' systems of governance, see also *Wolfe*, Regulatory Transparency, Developing Countries, and the Fate of the WTO (March 1, 2003), available at http://www.cpsa-acsp.ca/paper-2003/wolfe.pdf.

to common law systems, but rarely found in the civil law legal tradition.[136] Therefore, increased transparency and amicus curiae briefs could have disparate impacts on parties with different legal backgrounds and, accordingly, different levels of experience in dealing with such briefs – a possibility that has caused some fear of unduly overburdening one party and thus interfering with a neutral and fair process.[137]

Worries about an undue burden are usually accompanied by the expectation that opening up the proceedings would likewise open up "floodgates" and cause uncontrollable numbers of submissions.[138] Given the limited financial resources particularly developing countries have at their disposal, there is some concern about their capacity to respond properly to a high number of amicus curiae submissions.[139] According to some commentators, this potential inequality is further aggravated by the difference in funding and experience as far as civil society and business groups in the industrialized world on the one hand, in developing countries on the other are concerned.[140]

In any event, to effectively manage potentially high numbers of amicus curiae submissions, conditions as to which third parties may file under what circumstances need to be established. While the traditionally informative role of amici curiae and their legitimizing function in arbitration proceedings implicating the public interest have been elaborated upon above, however, now a number of questions about their own legitimacy arise: If the traditional filter function of an elected government is abandoned in favor of direct submissions by interested groups, what does this mean in terms of democratic representation of the majority's will in a given country? How are such groups, many of which are not exactly characterized by internal transparency or democratic structures themselves, legitimized, given that they are not accountable to a constituency? Therefore, it could be argued that increasing transparency and allowing amicus curiae submissions opens the door for well-organized, vested interests to bypass the domestic decision making and lobbying process, making capture actually more instead of less likely.[141] Distinguishing between groups

136 With respect to amicus curiae submissions in the context of NAFTA, Mexico opposed allowing submissions because this would import a concept known to U.S. and Canadian parties, whereas Mexico, as a civil law state, had no experience in this regard. See *Methanex*, supra note 53, para. 9.

137 To counter such fears, tribunals ruling on their powers to accept amicus curiae submissions have emphasized the need to establish procedures safeguarding parties' equal rights. See for instance *Aguas Argentinas*, supra note 49, para. 29; *Methanex*, supra note 53, paras. 35 et seq.

138 *South Centre*, supra note 107, para. 37, refers to the recent case *Aguas Del Tunari v. Bolivia* (ICSID Case No. ARB/02/3), in which over 300 interested parties petitioned for the right to intervene, attend hearings, and receive full public disclosure of all evidence and pleadings. Cf. also *Carmody*, Beyond the Proposals: Public Participation in International Economic Law, 15 Am. U. Int'l L. Rev. 1321, 1346 (2000), arguing that "evidence does not suggest that the floodgates have opened to date."

139 *South Centre*, supra note 107, para. 37.

140 *Id.*

141 *Ullrich*, No Need for Secrecy?, 34 U.B.C. L. Rev. 55, 77 (2000).

which may legitimately file in a given case and those which may not, however, could prove rather difficult, burdensome and expensive.[142] In addition, one might point out that in private law disputes in many legal systems, amicus curiae briefs submitted by government agencies or organs are considered to give a voice to the public and deemed to address ramifications of a claim that go beyond the effects on the individual parties – that is to say, the very involvement of the government as such represents the "public interest."[143] From this angle, allowing third parties to address public interest issues in state-investor arbitration, where the government is necessarily already involved, might seem superfluous.

Finally, increasing transparency and allowing third party submissions represent a significant step in the process of judicilization of investment arbitration proceedings, i.e., moving it closer to "ordinary" litigation.[144] This development robs arbitration of two of its perceived core strengths, confidentiality and privacy, and might give rise to concerns about reputation among both private claimants and states involved.[145] Moreover, from a game theoretic point of view, it may cause problems in terms of posture and efficiency losses.[146] Accordingly, some commentators have already opined that due to this development, conciliation might be the preferable route to go in future investment disputes.[147]

142 This were only different if instead of including a set of criteria in the ICSID Arbitration Rules or leaving it generally up to the respective Tribunal, a working system of self-regulation and pre-selection among civil society actors could be established. See thereto generally *Rebasti/Vierucci*, A Legal Status for NGOs in Contemporary International Law?,7, available at: http://www.esil-sedi.org/english/pdf/VierucciRebasti.PDF.

143 See, for instance, the U.S. Federal Rules of Appellate Procedure 29 (a); cf. also *Gruner*, Accounting for the Public Interest in International Arbitration, 41 Colum. J. Transnat'l L. 923, 956 (2003).

144 Regarding this trend, see generally *Leahy/Bianchi*, supra note 5, 51-52.

145 In the case of states, the potential loss of prestige could further be accompanied by political repercussions, see *Böckstiegel*, supra note 7, 584. It is here submitted, however, that this is but one consequence of democratic accountability and thus as such no valid reason to uphold confidentiality in state-investor arbitration.

146 Transparency provided by open proceedings may particularly affect the negotiation of compromises or „amicable settlements" in the pre-hearing phase (see ICSID Arbitration Rule 21; ICSID Additional Facility Rules, Schedule C Art. 29 (2)), for under public scrutiny, no party can afford to give in on their initial stand. Generally as regards game theoretic costs of transparency associated with the "posture" problem, see *Stavasage*, Open-Door or Closed-Door? Transparency in Domestic and International Bargaining, 58 International Organization 667, 668 and *passim* (2004).

147 *Coe*, Toward a Complementary Use of Conciliation in Investor-State Disputes - A Preliminary Sketch, 12 U.C. Davis J. Int'l L. & Pol'y 7, 23, 26-27 (2005).

III. Evaluation of the Proposal and the Adopted Changes – The Perspectives of Increased Transparency

With a view to the possible costs and benefits of transparency and third party participation, how should the latest developments in the Aguas Argentinas and Aguas Provinciales arbitrations, the ICSID Secretariat Draft Proposal and the actual amendments be evaluated?

First of all, it is safe to assume that when the Contracting States signed the Convention, thereby consenting to investor-state arbitration, they certainly did not foresee possible future amendments to the ICSID Arbitration Rules creating a prior consensus requirement regarding *closed* proceedings or Tribunals exercising discretion as to whether admit amicus curiae submissions in spite of party opposition. As a matter of fact, even in the NAFTA context, where the US and Canada recently have been very active in promoting transparency, the third party to the treaty, Mexico, has only recently and rather hesitatingly joined some of the newly adopted policies.[148] In a similar vein, the ICSID Secretariat has been severely criticized for its initiative, for it were too political and bypassed the mandatory legal process for amending the Convention, a power which "rests with the political (sovereign) power of the Contracting States."[149] In this light, the developments represented by the ICSID Draft Proposal, by the adopted changes and by the Aguas Argentinas and Aguas Provinciales orders might indeed signal a possible changing of the tide as regards confidentiality and the consensus principle in investment dispute arbitration. This shift not only affects states, but it also concerns investors fearing loss of business secrets and, more importantly, a negative impact on their reputation – it should be remembered that in Aguas Argentinas and Aguas Provinciales, it was the private claimant who opposed third party participation. In any event, against this background, the fact that the Secretariat considered some of its suggestions merely "clarifications" and Tribunals have based their powers to allow third party submissions on interpretations of existing rules does not justify sweeping claims that this was a "phenomenon that has emerged with the consent of states, not in spite of them."[150] In my opinion, increasing transparency and opening up proceedings is a general trend which should not – and ultimately cannot – be stopped, even though member governments for now have refused to fully adopt all changes that were originally proposed.[151] What is nevertheless worth remembering in this context, however, is that the whole system of investor-state arbitration, notwithstanding more and more elaborate rules, at the end of the day depends on the good-faith application of rules and on the willingness of states to actually enforce awards. It is only in

148 See NAFTA Free Trade Commission, Joint Statement on the Decade of Achievement (San Antonio, 16 July 2004), supra note 36.

149 *South Centre*, supra note 107, paras. 16, 23-28.

150 *Hollis*, Private Actors in Public International Law: Amicus Curiae and the Case for the Retention of State Sovereignty, 25 B.C. Int'l & Comp. L. Rev. 235, 243 (2002).

151 See supra, note 93.

this regard that a state's "general and perpetual consent" to the system, its current evolution and potential future developments indeed remains vital.

That being said, the reforms suggested were rather moderate and well-balanced, their only partial adoption is thus somewhat disappointing. Mandatory publication of excerpts containing the legal conclusions of a case obligates the Secretariat and will have positive effects on coherence and predictability without infringing on parties' rights. The clarification that Tribunals may accept amicus curiae briefs is in line with the interpretation of the Aguas Argentinas and Aguas Provinciales Tribunals and seems dogmatically accurate. Conceptually, it is not a radical proposal, but a challenging proposal: In order to safeguard efficient, fair and balanced proceedings, Tribunals will have to carefully evaluate which third party submissions to accept and whether to consider the information contained therein. Moreover, Tribunals need to be aware of resource and timing issues and find a balance between public interest and traditional party control.[152] The indicated criteria are in my view adequate to ensure that neither parties nor the Tribunal are excessively burdened by the briefs and by and large conform with current practice of NAFTA tribunals operating under UNCITRAL rules, assigning a "quasi-expert" status to amici.[153] By doing so, Tribunals have acted very responsibly and limited third parties to an informative, "classic" amicus curiae role. This avoids some of the potential costs feared by opponents to third party participation, while preserving its benefits in cases with public interest implications. In contrast, a further-reaching "right" to have amicus curiae briefs considered or to even actively participate in pleadings, as sought and suggested by some commentators,[154] should even *de lege ferenda* not be granted. A friend is a friend is a friend – and not a party. Nor is it plausible to assume that amici could not make their points effectively through written submissions.[155]

As to the originally proposed right of the Tribunal to allow third parties to attend all or parts of the hearings, it may be argued that this would have been a more fundamental departure from traditional state-investor arbitration than the question of amicus curiae briefs. The fact that member government for the time being were not prepared to adopt such a measure would further support such a stand. Given the absolutely vital impact of such transparency on the legitimacy of the arbitration process and, in my eyes even more importantly, on the accountability of the governments involved, however, this development is – at least in the long run – unstoppable. In this respect, some of the arguments advanced against such openness,

152 Cf. with regard to dispute settlement in the WTO *Morrisson*, Comment, in: *Clark/Morrisson*, Key Procedural Issue: Transparency, Comments, 32 Int'l Law. 851, 860 (1998).

153 *Mistelis*, Confidentiality and Third Party Participation, in: International Investment Law and Arbitration 169, 198 (*Weiler* ed., 2005).

154 See *Ford*, What are „Friends" for? In NAFTA Chapter 11 Disputes, Accepting Amici would help lift the Curtain of Secrecy Surrounding Investor-State Arbitrations, 11 Sw. J. L. & Trade Am. 207, 253 (2005).

155 *Howse*, Kantor-Howse Exchange Regarding Restrictions on Public Access to ICSID Arbitrations, available at: http://gasandoil.com/ogel/samples/freearticles/article_57.htm.

such as possible detrimental effects on foreign investment if the defense brought forward by states was exposed to public scrutiny,[156] are quite telling and by themselves evidence enough that more openness is called for. As a matter of fact, it is debatable whether instead of opening the proceedings to additional groups of people, there should be a general presumption of open hearings.[157] In a similar vein, amending the ICSID Additional Facility Rules and, albeit an unlikely scenario, the Convention and ICSID Arbitration Rules to provide for the mandatory publication of complete awards would be a welcome development.

Taking everything into account, most, if not all, potential costs of increased transparency can be avoided if Tribunals carefully exercise their discretion in the fields of transparency and third party participation. And, because the parties choose their arbitrators and trust them to rule on the substantive issues, there is no convincing reason why tribunals should be unfit to properly manage these procedural competence as well.

E. Conclusion

We have seen that third party participation and transparency are important notions in the field of state-investor arbitration, yet in practice have traditionally been limited. The recent amendments following the ICSID Secretariat Draft Proposal and the orders in the Aguas Argentinas and Aguas Provinciales arbitrations, however, indicate an important change, which is in line a general development in investment dispute settlement arbitration. To conclude our discussion of transparency and third party participation in ICSID proceedings, the following theses sum up the issues covered:

Largely modeled after private commercial arbitration, rules governing state-investor arbitration have traditionally provided very little mandatory transparency and virtually no opportunities for third party participation. Consequently, increasing transparency and allowing third party input has been at the discretion of the parties, often requiring consensus. Insofar, the rules established by the Convention and the ICSID Arbitration Rules 2003 are more or less typical examples.

While it is debatable whether there really is a general and absolute confidentiality principle in commercial arbitration, keeping these proceedings and their outcome private does generally not encounter serious concerns with regard to public interest implications or democratic legitimacy. As far as state-investor arbitration is concerned, however, the often highly sensitive subject matter covered and possible

156 *South Centre*, supra note 107, para. 43.

157 *Mann/Cosbey* et al., Comments on ICSID Discussion Paper "Possible Improvements of the Framework for ICSID Arbitration, International Institute for Sustainable Development (IISD), 10-11, available at: http://www.iisd.org/pdf/2004/investment_icsid_ response.pdf.

wide-reaching ramifications of a case that go beyond the effects on the respective parties draw a different picture.

As a prerequisite for accountability, transparency is vital in ensuring the acceptance and democratic legitimacy of investment arbitration and the governments involved. Furthermore, it also fosters coherence in the emerging body of international investment law and functions as predictability-enhancing incentive for foreign direct investment. Amicus curiae briefs can offer unique perspectives, provide tribunals with additional expertise, and mirror civil society's take on issues bearing on the public interest.

Given both the public pressure for reform and the sketched benefits of transparency, the NAFTA parties have attempted to radically overhaul existing confidentiality rules and provide for more openness, thereby "judicializing" the arbitration process. This trend has been reflected in recent awards rendered under UNCITRAL rules. The ICSID Secretariat Draft Proposal and, to a slightly lesser extent, the changes actually adopted, pick up on this trend.

The reforms are rather moderate, well-balanced and should be applauded. Mandatory publication of excerpts containing the legal conclusions of a case as well as the clarification that Tribunals may accept amicus curiae briefs if suitable are not radical proposals and do as such not unduly infringe parties' rights. The originally proposed right of Tribunals to open proceedings, however, would have been more fundamental and would have constituted a necessary, highly important and welcomed step towards more accountability of governments involved. Therefore, even though the Administrative Council for now shied away from adopting this amendment, the necessary changes will only be postponed, not abolished.

Most, if not all, potential costs of increased transparency can be avoided. In order to safeguard efficient, fair and balanced proceedings, tribunals will have to carefully evaluate which third party submissions to accept and whether to consider the information contained therein. There is no reason not to trust their ability to do so. By contrast, a "right" to have amicus curiae briefs considered or to even actively participate in pleadings should not be granted.

In addition to the necessity of introducing open hearings, amending the ICSID Additional Facility Rules and, albeit an unlikely scenario, the Convention and ICSID Arbitration Rules to provide for the mandatory publication of complete awards would be a welcome development.

Transparency and Third-Party Participation in Investment Arbitration

Comment by *Karl-Heinz Böckstiegel*[*]

First of all, it should be noted that this Frankfurt Conference, so well organized by my colleague *Rainer Hofmann*, in spite of the many meetings now held worldwide on investment and particularly ICSID arbitration, by its program and also by the involvement of young brilliant researchers in addition to the "usual suspects", contributes efficiently to the many questions that still need comprehensive examination both academically and in practice.

And further, it should be noted that the paper presented by *Carl-Sebastian Zoellner* at this conference gives an insight and overview on information and discussion on the topic of transparency which has not been available so far and, therefore, will be very useful. This is so, irrespective of the fact that some in the field, including myself, may not agree with every conclusion he submits.

I am afraid my own comments, given more or less spontaneously at the Conference on the basis of my own experience as an arbitrator in investment cases, will have to be short, because the task of putting them on paper for this publication falls into a time in which other commitments accepted long before, many due to my investment arbitration cases, leave little time.

First of all, one has to recall that it is not by accident that arbitration, including international arbitration, has traditionally been *in camera.* The rise of international arbitration to the present situation where it is at least internationally the by far most frequently accepted method of dispute settlement in international trade and investment has been and is only possible by agreement of prospective parties to contracts or treaties submitting to arbitration. One of the main reasons usually mentioned for this submission is the confidentiality of the proceedings. This is particularly so for commercial arbitration between private enterprises, but also for arbitration between states and private enterprises.

In this context of course, one has to accept that states or state institutions or state enterprises may have additional political and/or legal responsibilities to give account of their contracts and disputes to the general public at large or at least to certain

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public administrative or legislative institutions. But, on the other hand, in most states such reporting duties are limited by law and practice, because one is aware that concluding and performing international contracts efficiently requires a certain degree of trust and cooperation between the parties which is not fit to every step and decision being the object of public discussion and justification in what easily may become a political debate. Similar considerations prevail for arbitration, where the efficient representation of a party's interests may be hindered by public and particularly political discussions and where due process and the administration of justice call for a de-politicized process in the view of both the states and the private enterprises involved.

There is no need to reiterate here the present status and the main considerations regarding transparency in international economic law and the development of the practice of ICSID and the recent discussion regarding ICSID proceedings well summarized by *Zoellner*. Indeed, in response to a respective invitation, I participated in that discussion on the future of ICSID by correspondence and in meetings in London and Washington DC. For good reason, proposals for more transparency of ICSID proceedings were put forward and have been taken into account by ICSID Tribunals and in the recent process of adopting amendments of various ICSID provisions that came into effect on 10 April 2006. As *Zoellner* rightly indicates in the updated version of his paper, the changes are limited:

- The new Rule 37(2) provides that Tribunals may accept *amicus curiae* submission.
- The new Rule 32(2) authorizes the Tribunal to allow third persons into the hearing "unless either party objects", whereby the parties still enjoy a *de facto* veto right.
- And finally, the new Rule 48(4) provides the mandatory and prompt publication of legal excerpts of awards by ICSID while the full publication of awards still remains subject to approval of the parties.

But in the context of this rather limited opening in comparison to the former version of the ICSID Rules, it should also be noticed that, in responding to much further going options presented by the ICSID Secretariat, the replies from the member states showed considerable hesitation to go "all the way" into full transparency of ICSID proceedings and admitting third parties and particularly national and international non-governmental organizations and interest groups to participate in case proceedings.

My own personal experiences as an arbitrator in investment arbitrations are limited in this regard and are obviously under the old version of the Rules. Over many years, there were no suggestions or attempts for more transparency or admission of third parties to proceedings in which I participated.

When I chaired the first NAFTA investment arbitration in the Ethyl Case, which was between a US investor and the Government of Canada, Mexico made use of the opportunity expressly provided for in NAFTA Chapter 11 and did submit additional briefs which our Tribunal took into account.

In one of my ICSID cases some years ago, though ICSID, according to its usual practice, asked the Parties for approval to publish our award and did not receive it from both parties, counsel of one of the parties put our award on the website of its law firm and, since the award was now public knowledge, no further action or sanction was taken.

In one of my other ICSID cases, since the case seemed to raise considerable public and political attention in the host state being the respondent in the proceedings, a national television station in that country asked for permission to bring live coverage of our hearing in Washington DC to the public in the host country. Making use of the Tribunal's discretion under (the old) ICSID Arbitration Rule 32, we decided that that provision seemed to imply an only limited attendance of hearings and that such a live coverage might change the character of pleadings and was not in the interest of an efficient procedure. Permit me to add that I also had difficulties imagining that a considerable television audience in a far away country would be interested to follow the technicalities of pleadings, procedural discussion and cross examination in a foreign language, English, in Washington DC.

In the same case, after the hearing *in camera* was concluded and the transcript of the hearing had been distributed to the Parties and the Tribunal, counsel of one of the parties put that transcript on the website of its law firm. When the other party objected, the Tribunal recommended to withdraw the publication from the website, and counsel complied with that recommendation.

Turning to NAFTA, after considerable discussion on transparency, particularly in the United States, NAFTA Chapter 11 investment arbitrations have become more transparent in a number of ways. The best illustrations are perhaps the wide scope of respective publication made available on all NAFTA cases involving claims against the United States on the website of the US Department of State which discloses comprehensive information including full texts of procedural documents,as well as the website *NAFTAClaims.com* operated by Prof. *Todd Grierson Weiler*.

On the other hand, one has to realize that, for decades, investment disputes have been and still are submitted to and decided under the rules of the well known institutions for international commercial arbitration such as the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA) and sometimes as well the rules of national arbitral institutions such as those of the Stockholm Chamber of Commerce (SCC). In fact, of the hundreds of new international arbitration cases started every year at the ICC, regularly more than 10 % involve states as parties. In all of these, the traditional confidentiality of the arbitration proceedings is maintained and – as I know from the many of such cases in which I have served as an arbitrator – the Parties insist on that confidentiality.

Zoellner repeats the distinction sometimes made that, in commercial arbitration, keeping the arbitral proceedings and their outcome private does generally not encounter serious concerns with regard to public interest implications or democratic legitimacy, while in state-investor arbitration, the often highly sensitive subject matter covered and possible wide-reaching ramifications of a case go beyond the effects on the respective parties. With all respect, from my experience, that distinc-

tion often is not valid. There are ICSID cases which deal with investments of relatively small importance for the respondent host state and small amounts in dispute, and commercial arbitration cases under the ICC and UNCITRAL Rules on major infrastructure construction, oil, nuclear and geothermal energy, telecommunication and similar investments of fundamental importance and high political attention in the host state for periods of up to 30 years and for amounts of several billion US-Dollars in dispute. It is hard to say that transparency is important for the former and not for the latter.

Thus, in conclusion, I submit that, on one hand, there are good reasons for more transparency in investment arbitration and more transparency has indeed been realized in recent amendment of relevant provisions and practice. But on the other hand, one has to realize that many parties including state parties consider confidentiality of the arbitral proceedings as important to them and may decide not to submit to arbitration rules that do not maintain that confidentiality. If we neglect such preferences of the parties, we may end up with transparent procedures satisfying understandable concerns, but not chosen by parties.

Opening the Investment Arbitration Process: At What Cost, for What Benefit?

Comment by *Noah Rubins*[*]

A. Introduction

I first became aware of the issue of "transparency" in investment arbitration in February 2002, not long after the conclusion of hearings in *Loewen v. United States*, when renowned American journalist *Bill Moyers* broadcast a television documentary called "Trading Democracy."[1] In the program, Moyers attacked the very idea of investment arbitration as an "end run around democracy," where "secret NAFTA Tribunals can force taxpayers to pay billions of dollars in lawsuits filed by corporations against the United States." The documentary focused in particular on the *Loewen* case, and expressed shock that "boutique" law firms (a group that expressly included the multinational firm of more than 2,000 lawyers to which I then belonged) were quietly challenging legitimate regulation and "local traditions" in the United States on the basis of "obscure" treaty provisions.

Continued pressure from various quarters, particularly within the NGO community, has given rise to a prolific discussion of the openness of investor-State arbitration proceedings.[2] Practical developments, both at the institutional level and on the part of individual treaty-based tribunals, have led to a level of publicity unprecedented in the annals of international arbitration, including consistently published awards, hearings accessible to the public, and the submission of *amicus curiae* briefs from non-parties. Despite the rapid change in this area, it appears that insufficient consideration has been given to the full scope of interests at stake in bringing so much light to the formerly somber recesses of extra-judicial dispute resolution, with a number of important issues simply taken for granted in the rush to protect the investment arbitration "system" from cries of foul from certain political forces and special interest groups.

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1 For a transcript of the program, *see* www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB65/transcript.html.

2 See, e.g., *Atik*, Legitimacy,Ttransparency and NGO Participation in the NAFTA Chapter 11 Process, NAFTA Investment Law and Arbitration 135 (*Weiler*, ed. 2004); *Mistelis*, Confidentiality and third Party Participation: UPS v. Canada and Methanex Corp v. United States, International Investment Law and Arbitration 169 (*Weiler* 2005); *Teitelbaum,* Privacy, Confidentiality and Third Party Participation: Recent Developments in NAFTA Chapter Eleven Arbitration, 2 The Law and Practice of International Courts and Tribunals 249 (2003).

Many of the proponents of increased public access and openness have relied extensively on the concept of "transparency." This is an understandable rhetorical approach: there is growing consensus among prestigious international institutions, and in particular the World Bank and OECD, that transparency is an essential element of good governance, for corporations and States alike. Transparency in the awarding of State contracts, for example, is understood to increase predictability and efficiency, reduce the incidence of corruption, and bring important benefits to the populations of developing States. So cloaking arguments related to investment arbitration procedure in the mantle of "transparency" promises a certain level of public support by analogy. But the adoption of "good governance" terminology cannot convert questions of dispute resolution procedure into questions of good governance. The issues and interests at stake are very different, and therefore it is important to use concepts appropriate to the task of objectively evaluating the need and modalities for additional openness in arbitral proceedings.

There are three very distinct types of so-called arbitral "transparency," each with its own characteristics, costs and benefits. The first involves *pre-award disclosure*, allowing the public access to oral and written arbitration proceedings. Pre-award disclosure has a number of aspects, from the publication of basic information about a dispute (already carried out systematically by ICSID with regard to the cases it administers), to circulation of pleadings and hearing transcripts (practiced until recently only in NAFTA cases),[3] to the ultimate pre-award openness, the right of the public to attend or observe oral hearings. The second form of arbitral openness is *post award* disclosure, *i.e.* the publication of awards and other information about a dispute once the proceedings have drawn to a close. The final type of "transparency," the most extreme and controversial, involves *privacy* rather than disclosure. By privacy, I mean to refer to the word "privity," the state of being a full-fledged participant in the dispute. In practice, the issue of privacy has been expressed through the debate as to whether non-party entities might be permitted to make *amicus curiae* submissions to an investment arbitration tribunal.[4]

Whether each of these three aspects of "transparency" (or "opacity," as the case may be) presents a problem to be addressed on a systemic basis (to the extent one can presume that we are dealing with a unified "system" – more on that later) is a question that should be answered only after a serious cost/benefit analysis. While the categories of cost and benefit are similar for each type of transparency, the magnitude of cost and benefit appears to differ for each. It is also important not to take for granted the different costs and benefits that accrue to the variety of different

3 For a recent example of this form of pre-award disclosure in the ICSID context, *see Malaysian Historical Salvors, SDN, BHD v. Malaysia,* ICSID Case No. ARB/05/10, http://www.worldbank.org/icsid/cases/caseARB-05-10.htm.

4 *Amicus curiae* submissions have become a limited but integral part of litigation before the WTOs Appellate Body. *United States–Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, WTO Appellate Body Report of 6 November 1998, paras. 105-108.

stakeholders in and around the investment arbitration "system." It should be uncontroversial that costs and benefits inure differently to investor-claimants, respondent States, national constituencies within the host state, arbitral institutions, non-governmental environmental protection organizations, etc.

B. The Perceived Advantages to Openness

The literature has identified three primary advantages to increased "transparency." These perceived benefits should not be taken for granted, but should rather be viewed with a critical eye.

I. Closing the Democracy Gap

Closing the "democracy gap" is the benefit most discussed, and was the one emphasized in *Bill Moyers'* television program, mentioned at the beginning of this paper. Investment treaty arbitration has adopted the structure and procedure of "private" commercial arbitration systems, with adjudication behind closed doors. This may be appropriate in the private context, where business conflicts have little impact on third parties, and where the public disclosure of sensitive commercial information or trade secrets may unnecessarily harm the parties. But in investor-State disputes, such secrecy is "un-democratic" (so goes the argument), because it can subject to critique the laws and regulations enacted by the duly-elected legislators or executives of the host State. But this discussion raises the question as to how broad this democracy gap really is. Is there not a range of activities related to democratic governance that are outside the public purview? And perhaps more importantly, how is the challenge of a regulation in treaty arbitration different in terms of public interest and impact on third-party interests from the challenge in commercial arbitration of the State's performance under a contract to buy public goods or services?[5] If the transparency of arbitration is to depend simply on "public interest," then separate rules will have to govern the process *whenever* a State is involved, not just in treaty cases.

II. Painting the Full Picture

A second often-cited benefit of arbitral "openness," primarily in the context of permitting *amicus curiae* submissions from non-parties, is that the arbitral tribunal will

5 Indeed, the courts in Australia have curtailed the confidentiality of arbitration in commercial cases that substantially affect the "public interest." *See Esso Australia Resources Ltd & Ors v Plowman (Minister for Energy) & Ors* (1995) 128 ALR 321.

be better able fully to understand the dispute before it once it has received information from sources other than the disputing parties. The theory is that both the claimant and respondent State have strategic and political interests that limit the scope of information and argumentation they will provide to the arbitrators. But while the parties to investment arbitration (and their counsel) are surely selective about the way they present their case, it stands to reason that each of them is best positioned to determine the optimal strategy to prevail.

Given that *amicus* submissions are normally submitted in support of one of the parties (most frequently the respondent State), it would seem that an *amicus* brief offering information extraneous to the supported party's submissions would threaten to undermine the very purpose for which it was created, interfering with the party's strategy for victory. Some observers contend that certain important information (the environmental impact of a measure or its absence, for example) is not at the disposal of the host State, or is ignored or discarded for reasons of bureaucratic capture. But these problems would appear best addressed from within the host State by the aspiring *amicus*. NGOs often have effective avenues to present their views and data to governments where they operate, and to ensure that this information is included in submissions.

It also stands to reason that the effectiveness of non-party submissions in providing a full picture of the dispute is largely a function of the wholesale opening of proceedings to public access. It is difficult to imagine an *amicus* brief that effectively fills the gaps in the parties' submissions, unless the submitting party has had the opportunity to scrutinize the case record. Therefore, in the absence of complete "transparency," with all of the incumbent difficulties and costs to the parties, it is questionable whether *amicus* submissions will advance the tribunal's analysis at all.[6]

III. Harmonization of Jurisprudence

The third primary benefit of transparency is the increased consistency of investment treaty jurisprudence. The threat of inconsistent decisions came to prominence in the wake of the *CME* and *Lauder* awards,[7] and has since found further impetus in other

6 See *Weiler*, Restrictions on Submissions of Amicus Briefs to NAFTA investment Arbitral Tribunals, TDM, February 2004.

7 *CME Czech Republic, B.V. v. Czech Republic*, UNCITRAL Partial Award of 13 September 2003 (finding Czech Republic liable for damages under Netherlands-Czech BIT); *Lauder v. Czech Republic*, UNCITRAL Award of 3 September 2001 (finding Czech Republic not liable under U.S.-Czech BIT). On the conflicting decisions, see *Bagner*, How to Avoid Conflicting Awards: the Lauder and CME Cases, 5 J. World Inv. & Trade 31 (2004).

pairs of cases where seemingly similar facts led to different outcomes.[8] Setting aside for the moment whether inconsistent decisions in investor-State arbitration pose a significant problem at all, it is questionable whether additional public access to arbitral documentation would in fact harmonize arbitration awards. For the time being, all arbitrators are instructed to decide only the case before them, with due regard to the absence of any rule of *stare decisis* in relation to awards rendered in other disputes involving other parties.[9] Until this fundamental rule changes, the increase of information about other tribunals and the basis on which they ruled should have little effect on the way tribunals adjudicate disputes. Moreover, arbitrators *already* have access to an unprecedented volume of prior decisions. Nearly every ICSID decision is available to the public within weeks or even days after it is issued. In the absence of binding precedent, is it really necessary or useful to ensure access to the voluminous submissions of the parties in prior disputes?[10]

C. The Costs of Openness

In addition to the limitations on the presumed benefits of arbitral openness described above, there are also potential costs that are insufficiently explored.

I. Politicizing Investment Disputes

Perhaps most important of these is the re-politicization of investment disputes. Investment treaties with direct recourse to arbitration were created precisely to eliminate the political element of economic disputes, which made outcomes unpredictable and unprincipled. In the words of *Horatio Grigera Naón*:

> International dispute settlement mechanisms are expected to provide a legal and technical - instead of a political - approach to the resolution of disputes regarding foreign investment. By advancing the resolution of disputes through the furtherance of principles of justice rather than politi-

8 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/01/13, Decision on Jurisdiction of 6 August 2003*; SGS Société Générale de Surveillance S.A. v. Republic of the Philippines,* ICSID Case No. ARB/02/6, Decision on Jurisdiction of 29 January 2004.

9 *See, e.g., Gas Natural SDG, S.A. v. Argentine Republic,* ICSID Case No. ARB/03/10, Decision on Jurisdiction of 17 June 2005, para. 36 ("The Tribunal wishes to emphasize that it has rendered its decision independently, without considering itself bound by any other judgments or arbitral awards").

10 It is a separate and valid question whether investment arbitration jurisprudence is, on the whole, less consistent than other legal systems, and whether lingering conflicts between individual case decisions are cause for serious concern. For the affirmative answer on both points, see *Franck*, The Legitimacy Crisis In Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, 73 Fordham L. Rev. 1521 (2005).

> cal accommodation (which may, of course, be pursued in parallel by other means) private international dispute resolution devices provide a better technical and appropriately depoliticized framework for the development of substantive law and principles regarding foreign investment protection likely to enjoy wide international consensus.[11]

The father of the ICSID Convention, *Aron Broches*, envisaged the investor-State dispute resolution system as way to create a more predictable and stable investment environment, and one in which disputes would be less likely to arise.[12] Whereas prior dispute resolution practices, such as diplomatic espousal, economic sanctions, and even gunboat diplomacy gave the advantage to economically and militarily powerful States, the new system was intended to place all States on equal footing, and to allow dispute resolution to occur on the basis of principle. Unfortunately, the litigation of disputes in conditions of complete publicity does not lend itself to such principled outcomes. Where parties are free to present their case to the "court" of public opinion, the risk of abuse and re-politicization is great. Of special concern is the possibility that claimant investors will relate an extreme and one-sided view of the facts underlying an investment dispute, imposing upon the respondent State the burden of criticism on a diplomatic level, immediate negative effects on external perceptions of its investment climate, pressure from international lenders, and other negative effects long before the parties' positions are assessed by an arbitral tribunal. In the worst case, an investor-claimant may initiate arbitration precisely with these effects in mind, hoping to obtain "nuisance value" compensation through extensive publicity, without regard to the actual merits (or absence thereof) of its claim.

A related and far from salubrious effect of re-politicization is the reduction of settlement opportunities. Since the foundation of ICSID, a large proportion of investment disputes have been resolved through amicable settlement before an award on the merits was rendered. Such an outcome is clearly in the interests of all the primary stakeholders, both in terms of arbitration cost savings, the possibility of preserving investment activities, and the elimination of any need to engage in enforcement of an arbitral award. But the early publication of extensive information about the merits of an investment dispute can result in the hardening of positions, particularly that of the respondent State. Government officials, particularly the mid-level bureaucrats who are typically charged with managing disputes with foreign investors, are subject to rather abstract pressures that can discourage settlement even in the most propitious circumstances. In a litigation proceeding, a result less than a total victory can be blamed on the arbitrator or judge, while the government official

11 *Grigera Naón*, The Settlement of Investment Disputes between States and Private Parties: An Overview from the Perspective of the ICC, 1 J. World Inv. 59-60 (2000).

12 *Broches*, The Experience of the International Centre for Settlement of Investment Disputes, International Investment Disputes: Avoidance and Settlement 75, 77 (*Rubin & Nelson*, eds. 1985). See also *Shihata*, Towards a greater Depoliticiztion of Investment Disuputes: The Roles of ICSID and MIGA, 30-32 (1993).

himself will have to take responsibility for any concessions included in a settlement agreement. This pressure is increased where public opinion has turned against the foreign investor, and therefore any compromise viewed as a betrayal of national interests. Likewise, where the investor levels allegations of mismanagement, corruption, or arbitrary conduct against the State and its officials, settlement may be tantamount to political suicide, perceived as (at least partial) admission of the facts alleged. It would seem that increased publicity (particularly one-sided and argumentative) can only intensify these forces, which form a significant barrier to amicable settlement in investor-State disputes.

II. Increased Time and Cost

Increased openness of arbitral proceedings is bound to have some effect on the speed and cost-effectiveness of the dispute resolution process. For less invasive types of "transparency," such as post-award disclosure of awards and pleadings, the added cost is minimal, and delay non-existent by definition. Other forms of public participation, in particular the submission and review of *amicus curiae* briefs, are of greater concern in this regard. The review of *amicus* submissions requires arbitrators first to determine whether a brief will be accepted at all, then a review of the submission once made, and finally an analysis of whether the contents of the submission should affect the tribunal's decision. Perhaps more significant still are the costs and time involved in the *parties'* review and response to non-party submissions. The resulting costs and delays are multiplied if a third party is given the opportunity to reply to critiques of its opinion raised by the parties.

Given the voluminous pleadings and massive legal costs already common in investment arbitration proceedings, and the burdens placed upon developing State respondents and small- to mid-sized corporate (or individual) claimants, even a modest increase in expense should be accepted only after careful consideration. Likewise, while speedy adjudication is hardly taken for granted in most investment arbitration cases, the delay caused by an additional round of briefing in response to *amicus* briefs could be significant.

III. De-Harmonization of the Procedural "System"

A final negative consequence of increased "transparency" that has received almost no attention is the introduction of additional heterogeneity into a procedural "system" that has already drawn criticism for its lack of internal harmonization. Mandatory public access to pleadings, awards, hearings, and the adjudicative process itself is generally accepted to require some adjustment to the treaty texts or procedural

rules governing investment arbitration.[13] Whether this will mean fundamental change to the Washington Convention, the ICSID Rules, or widespread alteration of individual consent documents such as model BITs, remains to be seen. Already certain modifications have been made to the ICSID Rules and, more drastically, to the U.S. Model BIT of 2004.

As these changes are implemented, the variations in procedural rules will widen between, for example, arbitration under the ICSID and UNCITRAL Rules, or pursuant to the BITs of the United States and the Netherlands. As a result, claimants will gain an additional (and unintended) advantage from their unilateral power to select the dispute resolution method of their choice. The risk of strategic behavior is particularly acute in light of recent jurisprudence granting "mailbox companies" access to BIT protections in certain circumstances.[14] A claimant who stands to benefit from broad publicity (a U.S. company investing in a less-developed country dependent upon U.S. foreign aid, for example) might seek arbitration at ICSID under the U.S. BIT, while a company preferring confidentiality (whether due to sensitive business information or skeletons in the closet) might choose UNCITRAL arbitration under a more traditional BIT through a corporate subsidiary of the appropriate nationality.

The result of this new facet of the "treaty shopping" problem is less predictability of both process and outcome. To the extent that investment arbitration is meant to stabilize the investment climate and provide both investors and States a view of how disputes are likely to be resolved, such a development would appear negative.

D. What Cost for Which Stakeholder?

With these (and other) costs and benefits in mind, does the balance tip towards increased openness, or the continued limitation of public access to investment arbitration? The answer to this question is likely to differ for each stakeholder in the arbitral process, *and* with respect to each of the three types of "transparency." This short presentation is not the place for a detailed analysis of the costs and benefits of each permutation of stakeholders and publicity, and below I suggest only a few relevant thoughts for consideration in this regard.

13 Naturally, the parties to a dispute are free to set the level of publicity for the adjudication of their dispute as they see fit. Moreover, tribunals have ruled that the applicable procedural rules (UNCITRAL and ICSID) provide them the authority to take certain steps in the interest of "transparency," should they deem such measures to be necessary and desirable. Most observers supporting increased openness, however, appear to favor a more systematic and mandatory approach to the issue, with a default rule implemented supporting public disclosure and the review of *amicus* submissions.

14 *See, e.g., Plama v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, para. 128 (under ECT, it is "irrelevant who owns or controls the Claimant at any material time").

The benefit of most concern to the *public at large* is clearly the closing of the much-touted "democracy gap." This defect is largely solved by post-award publication of decisions. It is for this reason that the general population in the only host State to experience "real time" opening of hearings – the United States – has reacted with disinterest to more extensive access. In the first investment arbitration with public hearings, for example, only four people attended. At the same time, the public bears very little of the direct cost associated with additional openness, except to the extent that pressure from publicity results in a disadvantageous settlement by their government. Naturally, such an outcome leads (in theory, at least) to an allocation of tax receipts that could otherwise be used to provide public services.

Non-governmental organizations, by contrast, glean only scant benefit from post-award transparency, since they focus upon influencing the outcome of particular arbitral disputes in accordance with the particular interests that they represent. Moreover, the "democracy gap" is of little concern to many NGOs, which are precisely created to overcome the under-representation of certain interest groups within the structure of democratic decision-making. NGOs do gain a significant benefit from pre-award publicity and the participation of non-parties in the arbitration process, since it is they who most often submit *amicus* filings.

For obvious reasons, *investor-claimants* gain only limited benefit from post-award publicity, since their efforts are centered on victory in the case at hand. Moreover, investors do not stand to derive significant advantage from the acceptance of *amicus* submissions. Most such filings are made on behalf of respondent States by non-governmental organizations, rather than by business groups. As explained above, however, the possibility of broad publicity before an award is rendered benefits claimants, in that the threat of disclosure can compel early settlement. The claimant bears little of the costs incurred as a result of this kind of transparency – most of which are carried by the respondent State. Of course, the claimant will have to pay part of the price for transparency, to the extent it results in increased legal expenses or delay in the rendering of an award.

Respondent States bear the brunt of the cost of increased pre-award publicity in investment arbitration. As noted above, the publication of factual allegations can increase pressure on respondent States in a number of ways. While accusations may run both ways, counterclaims are exceedingly rare in investment treaty arbitration. Therefore, it is primarily the respondent who will fear pre-award openness. In this regard, the increased risk of procedural abuse through the imposition and publicity of frivolous or exaggerated claims is an important cost. The respondent stands to benefit from the intervention of non-party actors, who tend to support the host-State position in their *amicus* submissions. But it is not always clear that such filings are wholly welcome, as they may be seen to distract from the more central aspects of the respondent government's defense.

E. Conclusion

The concern with pre-award transparency (and *amicus* submissions, which is founded upon the former kind of public access) is that investment treaties were devised to *de-politicize* investment disputes. Both claimant and respondent can attempt to use openness as a weapon contrary to this fundamental principle. Politicized disputes are less predictable in outcome than legal disputes, and therefore hinder FDI flows by making them more expensive. Moreover, the exposure during a dispute, and the resulting "parallel proceedings" in the court of public opinion hardens positions, exacerbates disputes, and makes amicable settlement less likely.

This is all above and beyond the relatively minor, but not insignificant cost of added time spent arranging for the reviewing third party submissions. In this regard, it seems logical that a system be devised for such intervenors to contribute to arbitration costs in exchange for the benefit they receive from *amicus* participation. Perhaps this is just part of the practical and logistical details that need to be worked out now that - supposedly - we are in consensus about the need for transparency. But such issues are likely to prove more difficult than has generally been recognized. Investment arbitration is not limited to adjudication within the ICSID system, and so amending the ICSID Rules is not enough. An inconsistency in confidential and privacy provisions between ICSID and UNCITRAL, for example, will only serve to deepen the heterogeneity of arbitration procedure of which the proponents of transparency already complain. Moreover, this variety of provisions can *only* benefit claimant investors, since it is their right in investment treaties to select from a menu of arbitration rules in accordance with their strategy in a given case.

All of this is not to say that awards - and *perhaps* pleadings – should never be made available to the public, after the close of arbitral proceedings. It would appear that the cost of such publication is minimal, and the potential benefit relatively great. The analysis for *pre-award* openness and de-privatization of the arbitration process is much more ambiguous. It appears that claimants stand to benefit most from such developments, and States who stand to bear the highest cost. This may be acceptable to the architects of the system, because: (1) States are *meant* to bear such a burden, because in return they receive a competitive advantage in FDI placement; (2) the third-party (*i.e.* public) benefit outweighs the cost; or (3) public pressure, not matter how irrational, is enough to bring the system crumbling down – a result that will adversely affect all stakeholders in the investment arbitration process. All this may be the proper result once the cost-benefit analysis has been undertaken. But the process has yet to begin, as most commentators have skipped to the end, presuming an answer that "feels right."

Is There A Need for an ICSID Appellate Structure?

Christian J. Tams[*]

A. Introduction

In October 2004, the ICSID Secretariat issued a Discussion Paper entitled "Possible Improvements of the Framework for ICSID Arbitration".[1] This paper came at a time when ICSID dispute settlement, judging from the number of pending cases, flourished. Yet the increasing number of proceedings not only signalled a general acceptance of the system, but also brought with it new problems – which the Secretariat apparently sought to tackle from a position of strength, by leading the debate about a number of reforms. The various measures suggested in the Discussion Paper were an interesting blend of purely technical issues and drastic measures of a far-reaching nature. Among the latter were proposals set out in Chapter VI and the Paper's Annex, in which the Secretariat showed itself prepared to "pursue the creation of […] an ICSID Appeals Facility",[2] and put forward rather concrete proposals for that option.[3] As commentators did not fail to observe, these proposals went to the heart of the ICSID system of dispute settlement and raised many issues of a fundamental nature.[4] In retrospect, it is curious how lightly they were raised. In fairness, it must be admitted that when suggesting the establishment of an appeals facility, the Secretariat responded to calls, by a number of ICSID member States (and notably the United States), for a reform of the existing dispute settlement system. Yet, the clear majority of ICSID participants voiced concerns during informal debates in late 2005 and early 2006, or even came out openly hostile against the idea. As a result, ICSID officials seem to have discarded any immediate plans for the creation of an appeals

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1 'Possible Improvements of the Framework for ICSID Arbitration' (22 October 2004), available on the internet: http://www.worldbank.org/icsid/highlights/improve-arb.htm.

2 *Ibid.*, para. 23.

3 *Ibid*.

4 See e.g. South Centre Analytical Note, 'Developments on Discussion for the Improvements of the Framework for ICSID Arbitration and the Participation of Developing Countries' (SC/TADP/AN/INV/1), available at http://www.southcentre.org.

facility, accepting that the earlier proposals had been considered by many as 'premature'.[5]

The present paper proceeds on the assumption that while temporarily off the agenda, the debate about an ICSID appellate system is not over. In fact, it may only be just beginning – but this time without the time-pressure that the Secretariat's reform proposal inevitably introduced. It is submitted that indeed, much more time is needed properly to evaluate the pros and cons of an appellate structure. The present paper seeks to contribute to that debate. It explores various arguments that might possibly militate in favour of a two-tiered system of dispute settlement (infra, section C.) but also assesses obstacles to such a reform (section B.), as well as alternatives to an appeals structure (section D.).

B. Obstacles

Before examining arguments that might support an overhaul of the present system, it seems necessary to discuss obstacles to reform. The present section addresses three rather different problems that any reform proposal must face. In very brief terms, these obstacles can be formulated in the following propositions:

- The ICSID dispute settlement system at present already allows for a review of awards in exceptional circumstances.
- The ICSID dispute settlement system deliberately restricted review to these exceptional circumstances, while otherwise stressing the need for finality.
- A reform of the ICSID dispute settlement system depends on stringent majority requirements and therefore requires broad political backing.

All three obstacles will be addressed in turn.

I. The Present System Permits a Review of Awards in Exceptional Circumstances

The first point to make is that even at present, there is some scope for a review of ICSID awards. When assessing that scope, it is necessary to distinguish between awards governed by the ICSID Convention proper, and those rendered under the Additional Facility Rules.

5 Investment Treaty News: 'ICSID Member-Governments OK watered-down changes to arbitration process' (29 March 2006), available on the internet: <http://www.iisd.org/ investment/itn/news.asp>. Cf. already the ICSID Working Paper 'Suggested Changes to the ICSID Rules and Regulations' (12 May 2005), available on the internet: <http://www.worldbank.org /icsid/highlights/sug-changes.htm>, para. 4.

1. ICSID Convention Awards

Awards rendered under the ICSID Convention can only be attacked by the procedures provided by the Convention itself. In particular, Article 54 of the Washington Convention obliges States to treat pecuniary[6] awards as if they were final judgments of the State's own courts. For the purposes of recognition and enforcement,[7] the ICSID Convention thus excludes any outside re-assessment of awards, or possibility of *vacatur*, by national courts. However, Article 54 is only part of the picture. It is one feature of a careful compromise struck during drafting. The other main feature is equally relevant and equally remarkable: internally, i.e. by mechanisms set out in the Washington Convention itself, ICSID awards *can* at present be reviewed. Unlike most other international dispute settlement mechanisms, the ICSID Convention not only recognises narrowly described forms of rectification, revision and interpretation of awards. In addition, Article 52 of the Washington Convention permits for a systemic review of awards in the form of an annulment procedure by *ad hoc* annulment committees. The scope of that annulment review has always been much discussed.[8] As the wording of Article 52 clarifies, there are five grounds of annulment: (1) the arbitral tribunal was not properly constituted; (2) it manifestly exceeded its powers; (3) a tribunal member was corrupt; (4) there was a serious departure from a fundamental rule of procedure, or (5) the award did not state the reasons upon which it was based.

At least at first glance, this list (which includes some rather vague notions such as "manifest excess of powers") may seem impressive. But Article 52 is important both for what it says and for what it does not say. While allowing for an unusual review procedure on five specific grounds, it implicitly excludes other forms of review.[9] In fact, clear evidence suggests that the drafters intended annulment to be an exceptional remedy and that the five grounds were to be narrowly construed.[10] More importantly, they were adamant that Article 52 should not be used as a form of substantive appellate review. In terms of the applicable standards governing systemic

6 The express reference to pecuniary obligations implies that non-pecuniary injunctions are not covered by ICSID's enhanced enforcement regime: see *Toope*, Mixed International Arbitration (1990), 245-246.

7 The Convention regime is less ambitious with respect to State immunity from execution: As Article 55 clarifies, Article 54 does not oblige States to enforce judgments which could not be enforced because of immunity from execution. For an explanation cf. the Report of the Executive Directors, 1 ICSID Reports, 32.

8 For the most detailed assessment see the commentary on Article 52, in: *Schreuer*, The ICSID Convention, and the various contributions in *Gaillard/Banifatemi* (eds.), Annulment of ICSID Awards (Huntington, 2004).

9 *Arnoldt*, Praxis des Weltbankübereinkommens (1997), 184; *Amadio*, Le contentieux international de l'investissement privé et la convention de la banque mondiale du 18 Mars 1965 (1967), 240.

10 For details see *Arnoldt*, Praxis des Weltbankübereinkommens, 184 *et seq*.

review, this means that Article 52 is only concerned with the procedural propriety of an award rather with its correctness as a matter of substance.[11]

Unfortunately, ICSID annulment committees have not always followed the text and spirit of Article 52. It is well known that at least some of them have taken a rather expansive view of their powers and have effectively used the concepts of 'manifest excess of power'[12] and 'failure to state reasons'[13] as stepping stones for a substantive review of the initial award.[14] While subsequent annulment decisions have adopted more restrictive approaches, it seems fair to say that the scope of Article 52 remains controversial.[15] It may simply be that Article 52, by requiring committee members to turn a blind eye on a potentially wrong decision, asks too much of highly qualified lawyers. But at least at the conceptual level, the limited nature of annulment under Article 52 is of crucial importance, and the distinction between annulment and forms of substantive review needs to be maintained. While not providing for a comprehensive appeals system, the Washington Convention thus regulates questions of review in a very differentiated manner, striking a careful balance between the need for finality on the one hand, and the possibility of review on the other.

2. Additional Facility Awards

ICSID Additional Facility awards are governed by a rather different regime. Since there is no equivalent to Article 52 of the ICSID Convention, Additional Facility awards are not subject to any internal review procedure comparable to annulment. However, they can be attacked externally, before national courts, where recognition and enforcement must be sought.[16] At the seat of the arbitration, national courts can be asked to set aside awards in *vacatur* applications. During enforcement proper,

11 *Franck*, The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, Fordham Law Review 73 (2005), 1547; *van den Houtte*, Article 52 of the Washington Convention – A Brief Introduction, in: *Gaillard/Banifatemi* (footnote 8), 12; *Schreuer*, ICSID Convention (footnote 8), Art. 52 mn. 11.

12 Article 52(1)(b) ICSID Convention.

13 Article 52(1)(e) ICSID Convention.

14 For a detailed assessment of annulment jurisprudence see *Schreuer*, Three Generations of ICSID Annulment Proceedings, in: *Gaillard/Banifatemi*, (footnote 8), 17; *Schwartz*, Finality at What Cost?, *ibid*., 43. For highly critical reactions to the *Klöckner* and *Amco* annulment decisions see e.g. *Redfern*, ICSID – Losing Its Appeal?, 3 Arbitration International (1989), 98; *Reisman*, The Breakdown of the Control Mechanism in ICSID Arbitration, 1989 Duke Law Journal 739.

15 The debate between contributors to the volume edited by *Gaillard* and *Banifatemi* (footnote 8) testifies to this. Contrast e.g. *Schreuer's* positive assessment of the *Wena* and *Vivendi* decisions (e.g. at 18: "[T]he ICSID annulment process has found its proper balance.") with the highly critical pieces by *Schwartz* (43-86) and *Cremades* (87-95).

16 'Enforcement' is used here to include the recognition of the award; for a similar use of terminology see e.g. *Collier/Lowe*, The Settlement of Disputes in International Law (1999), 265.

respondents can ask national courts to refuse recognition – typically under the conditions set out in Article V of the 1958 New York Convention.[17] The rules governing these two forms of review are manifold.[18] But very simplistically, it can be said that awards can be reviewed for procedural defects broadly similar to the grounds of annulment set out in Article 52 of the ICSID Convention.[19] In addition, Article V(2)(b) as well as many national rules governing *vacatur* applications allow an award to be attacked if it and/or its enforcement is contrary to public policy.[20] This means that the scope for review is somewhat broader than under Article 52 ICSID Convention which deliberately opted against a public policy exception. Both under national laws governing *vacatur* applications and at the stage of enforcement proper, some courts have relied on public policy exceptions to perform a substantive review of awards. But these attempts are few and far between, and are difficult to bring in line with the overall aim of the New York Convention, which intends to enhance the prospects for enforcement.[21] Although applications of the public policy exception will often require national courts to look into the substance of an award, this means that enforcement should only be refused in highly exceptional circumstances. Again, this was a deliberate choice, aimed at preserving the integrity of arbitral awards, and at securing their enforceability.

II. The ICSID System Deliberately Opted Against Broader Options of Review

The previous considerations suggest that ICSID, already having some sort of review, may be an unlikely candidate for an appeals debate. But there is a second obstacle to reform, and that is the fact that the ICSID system deliberately opted against broader options of review. To some extent, this argument has been dealt with already, when discussing the scope of Article 52 of the Convention. Yet, rather than stressing the narrow scope of annulment (or of national court review, for that matter), one might equally underline the reasons leading ICSID drafters to restrict the options for review. Three such positive reasons can be distinguished:

17 330 U.N.T.S. 38. Similar provisions are included in the Inter-American [Panama] Convention on International Commercial Arbitration, OAS Treaty Series, No. 42.

18 For a more detailed assessment of the points made in the following see *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1548-1557.

19 See *Collier/Lowe* (footnote 16), 267-270, for further details.

20 For comment cf. *Toope* (footnote 6), 129-138.

21 In its Report, the New York Convention drafting committee noted that public policy exceptions could only come into play if enforcement would be "distinctly contrary to the basic principles of the legal system of the country where the award is invoked" (Report of the Committee on the Enforcement of International Arbitral Awards, 28 March 1955, UN Doc. E/2704 and E/AC.42/4/Rev.1.). For a detailed treatment of national courts' approaches see the ILA Study into the application of public policy by enforcement courts, eventually leading to a Resolution adopted at the ILA's 2002 New Delhi Session, both reproduced in International Law Association (ed.), Report of the Seventieth Conference (London, 2002).

- For a start, drafters were keen to establish a system that would solve disputes within a reasonable period of time[22] – hence their insistence on time-limits, and provisions preventing parties from frustrating proceedings.[23] The reason for this is not difficult to understand. Proceedings, whether judicial or arbitral, leave legal positions in abeyance and produce uncertainty. As a general matter, dispute settlement systems striving for efficiency should therefore seek to minimise the time spent on resolving legal and factual questions. In the case of investment arbitration, this rationale would seem to be particularly relevant.[24] Often, disputes concern important investment projects binding a relevant portion of a company's budget. By definition, investments prompting ICSID disputes also occur abroad, i.e. in a country in which the investor is not registered. Finally, as the sets of *Argentine* or *SGS* cases illustrate, parties (whether investors or States) may have entered into different contracts of a similar type, which means that one decision is likely to affect a variety of legal relations. Given these factors, the drafters were certainly correct in stressing the need for a reasonably quick resolution of disputes. Whether investment arbitration presently meets that goal is of course a matter for discussion. In contrast, it seems evident that whatever its design, an appeals structure would not reduce, but increase the amount of time lapsing before a definite decision on the merits. While much depends on time frames, it seems beyond doubt that introducing an appeals facility would complicate the task of resolving disputes quickly.
- The second point is related. It is based on a simple calculation: the longer the proceedings, the higher the costs. Again, much depends on the specific features of the appeals structure, but it seems clear that litigation in a two-tiered system is more expansive than with only one round of proceedings. This in itself is a potential drawback of a reform.[25] However, higher costs may have further implications: a more expansive litigation might deter smaller participants (whether smaller companies or poor States) from pursuing their rights.[26] It might there-

22 Cf. South Centre Analytical Note (footnote 4), para. 59.

23 Cf. e.g. Articles 45, 37(2)(b) and 38 of the ICSID Convention.

24 See *Tawil*, An International Appellate System: Progress or Pitfall?, Transnational Dispute Management 2/2005, 69 (70): "[I]nvestors require quick decisions as trust is a necessary requirement to be complied for investments to be done."

25 Cf. South Centre Analytical Note (footnote 4), para. 68: "A particular challenge, for developing countries, of the appeal facility is the cost of such a proceeding", noting that unlike in investment arbitration, "[t]he expense of the Appellate Body of WTO is born by the organisation itself" (*ibid.*).

26 Cf. *Wälde*, Alternatives for Obtaining Greater Consistency in Investment Arbitration: An Appellate Institution after the WTO, Authoritative Treaty Arbitration or Mandatory Consolidation?, Transnational Dispute Management 2/2005, 71 (74): "For a well-resourced government facing an under-resourced opponent (typically a smaller, entrepreneurial company with shallow pockets), an important strategy is simply to drain away the claimant's litigation war-chest until it is compelled to give up. Adding an appeal will reinforce the strength of such a litigation-resource based strategy."

fore act as an external factor harming the bargaining position of some ICSID participants.

- Lastly, ICSID drafters were prepared to place a considerable measure of trust in ICSID panels of arbitrators. They were convinced that an award, by these arbitrators, should be preserved at nearly all costs – hence the decision against any national court review and the narrow scope of annulment proceedings under Article 52.[27] This is not to suggest that their approach was the only acceptable one. However, it is a decision that was taken in 1965, and one that can certainly be described as fundamental to the ICSID dispute settlement system. Reversing it would not only mean a departure from the drafters' original intent. More importantly, the decision in favour of a second level of dispute settlement would also risk undermining the authority of the first level decision – i.e. the regular ICSID panels of arbitrators. If first-level decisions were regularly appealed, they might very well end up de-valued. In fact, experience with the WTO system of dispute settlement suggests that this is a risk that needs to be taken seriously.[28] In any event, that decision would show a considerable degree of distrust in the one level of dispute settlement in whose decision the Convention drafters deliberately placed great trust.

III. A Meaningful Reform Requires Broad Political Support

The preceding considerations suggest that both ICSID Convention and Additional Facility awards can be reviewed in exceptional cases, but are deliberately not subject to an appellate procedure. The proposed reform is therefore hard to reconcile with an essential feature of the present system. But there is a further, more practical obstacle: Meaningful reform proposals depend on stringent majority requirements. The degree of support required primarily depends on the type of appeals facility envisaged.

- The most ambitious proposal would be to introduce a single and comprehensive appeals facility competent to re-assess all awards rendered by ICSID tribunals. For that to be the case, the proposed appeals structure would have to be established by the very ICSID constitutional rules (whether ICSID Convention or Additional Facility rules). Unsurprisingly, this ambitious proposal faces the most serious problems of implementation. In the case of ICSID Convention awards, it would conflict with Article 53 of the Convention, which stipulates in no unclear terms that awards "shall not be subject to any appeal".[29] The most straightforward way of addressing this conflict would be to amend the Conven-

27 *Supra*, section B.I.1.

28 A statistical analysis shows that between 1995 and 2000, 77% of WTO Panel Reports were appealed: see *Park*, Statistical Analysis of the WTO Dispute Settlement System (1995-2000), in: *Petersmann/Ortino*, The WTO Dispute Settlement System (2004), 531 (541).

29 As *Sands/Mackenzie/Shany* observe (Manual of International Courts and Tribunals, 1999, at 90): "the exclusion of appeal is absolute".

tion. Pursuant to its Article 66, amendments require the ratification (or other form of approval) of each of the 143 member States. That far-reaching proposals should meet with a unanimous consensus however hardly seems realistic, at least in the short term. In the case of Additional Facility awards, matters would be less complicated, as there is no equivalent to Article 53. Still, Article 52(4) of the Additional Facility Rules (Schedule C)[30] declares awards to be "final and binding on the parties", which shows that the Additional Facility Rules envisage a one-level system of arbitration. To allow for a comprehensive system of appeals, they would thus have to be amended. While this would not require the support of all member States, it could only be done through a majority decision of the ICSID Administrative Council.[31]

- Given these majority requirements, it comes as no surprise that ICSID participants have begun to look for more feasible ways of allowing at least some parties to appeal some awards rendered by ICSID tribunals. These more realistic proposals would give up the goal of establishing a comprehensive appeals facility, and would open an appeals option for parties that jointly decide to avail themselves of it. The easiest way to do so would be to provide for an appeals option within the instruments establishing ICSID jurisdiction (typically bilateral or multilateral investment treaties). Alternatively, States could agree on a Protocol to the ICSID Convention specifically providing for appeals.[32] Legally speaking, nothing could prevent States and/or investors from so doing. As far as ICSID Additional Facility arbitration is concerned, parties of course are free to define the scope of ICSID arbitration, and could do so by establishing a second level of arbitration. With respect to ICSID Convention awards, these proposals would clearly circumvent Article 53, but would be justified as a valid inter-se modification.[33] Yet, while legally possible and politically more feasible, a system of appeals established under specific treaties might not be able to fulfil the hopes of those arguing for a reform of the ICSID system. This is a matter to be assessed more fully in subsequent sections of this paper,[34] but the main problem may be briefly referred to at this point already. If the appeals option depended on the provisions of investment treaties or a Protocol to the Convention, ICSID would offer a 'piecemeal appeal', open in some, but not in all disputes. If ap-

30 Available on the internet: http://www.worldbank.org/icsid/facility/facility.htm.

31 Cf. Article 6(3) of the ICSID Convention, which also served as the basis for the very establishment of the Additional Facility Rules. For comment see *Schreuer*, The ICSID Convention (footnote 8), Art. 6, mn. 23-26.

32 Cf. *Bishop*, The Case for an Appellate Panel and Its Scope of Review, Transnational Dispute Management 2/2005, 10.

33 Cf. Article 41 VCLT, pursuant to which an inter-se modification is permitted if it is not "(b) … prohibited by the treaty and: (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations; (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole."

34 *Infra*, section D.I.3.

peals structures were to be established by different investment treaties, there might eventually even be not one single, but different appeals facilities, possibly functioning according to different rules and standards.

C. Arguments for Introducing an Appeals Facility

The preceding section has sought to underline the difficulties to which the establishment of an investment appellate structure would give rise. The present section addresses arguments suggesting that notwithstanding these difficulties, the reform should be pursued. More specifically, it breaks down the different calls for reform into four (inter-related) arguments, and addresses each of them in turn.

I. An Appellate System Would Foster Consistency

The main argument supporting the establishment of an ICSID appeals facility is that such a facility could improve the consistency of international investment law. This argument is widely taken up by commentators. For example, in its discussion paper of late 2004, right at the start at the section considering an appellate structure, the ICSID Secretariat recognised that "the appeal mechanism would be intended to foster coherence and consistency in the case law"[35] (while also claiming that "[s]ignificant inconsistencies have not to date been a general feature of the jurisprudence of ICSID"[36]). Similarly, many commentators stress the need for an investment court of appeals uniting a seemingly fragmented body of law.[37] The propositions underlying this 'consistency argument' are that ICSID awards at present lack consistency, that this is a problem, and that an appellate body could solve it. All three issues will be addressed in turn.

35 ICSID Discussion Paper (footnote 5), para. 21.

36 *Ibid*.

37 See e.g. *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1617 *et seq*.; *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 10; *Goldhaber*, Wanted: A World Investment Court, The American Lawyer, Summer 2004 issue, available on the internet: http://www.americanlawyer.com/focuseurope/investmentcourt04.html. For earlier proposals see already *Holtzmann*, A Task for the 21st Century: Creating a New International Court for Resolving Disputes on the Enforceability of Arbitral Awards, in: *Hunter et al*. (eds.) The Internationalisation of International Arbitration: The LCIA Centenary Conference (1995), 111; *Schwebel*, The Creation and Operation of an International Court of Arbitral Awards, *ibid*., 115.

1. Are Investment Awards Inconsistent?

Disaggregating the issues, it is first necessary to assess whether there are at present inconsistent investment awards. The answer to this question is in the affirmative. At least in some instances, tribunals have rendered diametrically opposed or conflicting decisions, and have also openly criticised the reasoning of previous awards. As the cases are well-known, it may be sufficient to deal with them *en passant,* and to focus on the different types of inconsistency that they stand for.[38]

The *Lauder cases*[39] provide a spectacular example of opposite decisions by different tribunals, concerning the same set of facts, almost identical parties, and nearly identical legal norms. In fairness, it must be admitted that they were decided by UNCITRAL tribunals. Yet, their treatment may be justified here, as the decisions concerned substantive aspects of investment law not depending on a particular arbitral framework, and as they epitomise the problem of inconsistency. In essence, the two arbitral tribunals differed on the extent to which the Czech Republic had breached its obligations vis-à-vis a US American investor, Mr. *Lauder*, and a Dutch company (CME) controlled by him. A Stockholm arbitral tribunal found that the Czech Republic had committed an expropriation in the sense of Art. 5 of the Dutch-Czech BIT[40] when depriving CME of exclusive rights in the television business, holding that the relevant conduct (by the Czech Media Council) "smacks of discrimination against the foreign investor."[41] Faced with essentially the same expropriation standard in the US-Czech BIT,[42] the London tribunal held that the measures in question did not amount to an expropriation, as there had been no direct interference by Czech authorities, as Mr. *Lauder's* property rights had been maintained, and as the measure did not benefit the Czech Republic.[43] Based on their respective

38 For a more detailed treatment of the relevant awards see e.g. *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1558 *et seq*.

39 *CME Czech Republic B.V. v. Czech Republic*, Partial Award of 13 September 2001 and Final Award of 14 March 2003 (the 'Stockholm Award'); *Lauder v. Czech Republic*, Final Award of 3 September 2001 (the 'London Award'). All awards are available on the internet: http://www.investmentclaims.com/oa1.html. See also the subsequent decision by the Swedish Svea Court of Appeals, which decided not to vacate the Stockholm award: Judgment of 15 May 2003, available on the internet: http://www.investmentclaims.com/oa1.html.

40 Article 5 of the Netherlands-Czech Republic BIT provides that neither country "shall take any measures depriving, directly or indirectly, investors of […] their investments unless the following conditions are complied with: (a) the measures are taken in the public interest and under due process of law; (b) the measures are not discriminatory; (c) the measures are accompanied by just compensation."

41 Stockholm Award (footnote 39), para. 612.

42 Article III(1) of the US-Czech Republic BIT provides that: "Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (expropriation) except: for a public purpose; in a nondiscriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles or treatment provided for in Article II(2)."

43 London Award (footnote 39), para. 201.

reasoning, the Stockholm tribunal in its final award ordered the defendant to pay $355 million to CME, while the London tribunal refused to award Mr. *Lauder* any damages. Whatever the correct result, it is beyond doubt (and is widely accepted among commentators), that the contradictory result of the two Lauder cases has primarily had one effect: as was aptly put by one observer, it "brings the law into disrepute, it brings arbitration into disrepute - the whole thing is highly regretable."[44]

Instances like the different *SGS cases*[45] concern the conflicting interpretation, given by different ICSID tribunals, of a similar legal rule enshrined in different treaties, and applicable in similar cases between different parties.[46] The legal rules in question were versions of the much-discussed 'umbrella clauses',[47] contained in the BIT between Switzerland and Pakistan, and Switzerland and the Philippines. In different cases, ICSID tribunals had to assess whether this clause would transmute breaches of contract into treaty violations coming within the scope of the relevant BITs. In *SGS-Pakistan*, the tribunal adopted a narrow reading of the umbrella clause, which provided that host States "shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the Investors". Worried that each and every contract breach might be actionable before ICSID tribunals, it held there would have to be "clear and convincing evidence" that the State parties to the BIT intended to transform contract breaches into treaty claims.[48] In contrast, the tribunal in *SGS-Philippines* stressed the broad wording of the umbrella clause, by virtue of which a host State "shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other". While it sought to distinguish the formulations of the two umbrella clauses, presumably to avoid being chided for departing from earlier awards, the *SGS-Philippines* tribunal expressly criticised the award in the Pakistan case for inventing a presumption in favour of restrictive readings of umbrella clauses.[49] This suggests that the conflict between the two decisions cannot really be explained by the wor-

44 *Rushton*, Clifford Chance Entangled in Bitter Lauder Arbitrations, Legal Bus., Oct. 2001, 108 (cited in *Franck*, [footnote 11], Fordham Law Journal 73 [2005], at 1559). For similarly outspoken criticism see *Goldhaber* (footnote 37): "Czech taxpayers must think poorly of what passes for the world system of investment arbitration. […] The *Lauder* cases dramatize the tenuous legitimacy of investment dispute resolution."

45 *SGS Société Générale de Surveillance S.A. v. Pakistan*, Decision on Jurisdiction of 6 August 2003 ('*SGS-Pakistan*'); *SGS Société Générale de Surveillance S.A. v. Philippines*, Decision on Jurisdiction of 29 January 2004 ('*SGS-Philippines*'), both available on the internet: http://www.investmentclaims.com/oa1.html.

46 For a brief summary see *Gill*, Inconsistent Decisions: An Issue to be Addressed or a Fact of Life?, Transnational Dispute Management 2/2005, 12 (12-13).

47 On these see e.g. *Wälde*, The "Umbrella" Clause on Investment Arbitration – A Comment on Original Intentions and Recent Case, 6 Journal of World Investment &Trade (2005), 184-236; *Sinclair*, The Origins of the Umbrella Clause in the International Law of Investment Protection, Arbitration International 2004, Vol. 20 (4), 411-434.

48 *SGS-Pakistan* (footnote 45), para. 167.

49 *SGS-Philippines* (footnote 45), paras. 119-127.

ding of the respective treaties. In essence, the two tribunals adopted different interpretations of umbrella clauses. Taken together, the *SGS* decisions thus leave States and investors with a feeling of considerable uncertainty with respect to the meaning of such clauses.[50] Since the umbrella clauses were contained in *different* treaties, the tribunal's contradictory approaches, on a conceptual level, are not as problematic as the two *Lauder* cases.[51] But given the number of umbrella clauses within modern BITs, the practical consequences of the decisions are considerable.

Finally, a number of NAFTA cases shows that even when applying the same treaty norm, as opposed to identically-worded provisions of different treaties, arbitral tribunals do reach different conclusions. The different decisions in the cases of *S.D. Myers v. Canada,*[52] *Metalclad v. Mexico*[53] and *Pope & Talbot v. Canada*[54] are based on remarkably different interpretations of NAFTA's "fair and equitable treatment" clause, namely Article 1105. The *Metalclad* and *Pope & Talbot* tribunals seemed to consider Article 1105 to provide companies with a positive right existing independent, and going beyond, minimum standards of customary international law.[55] In contrast, in *S.D. Myers*, the tribunal took a different approach; it held Article 1105 to be violated when "an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective", thereby making Article 1105 dependent on general international law.[56] Again, for present purposes, it is not relevant to assess which of the tribunals took the correct approach. Rather, the three awards show that even within one and the same treaty system, different arbitral awards can create a level of uncertainty that is inimical to predictable and reliable dispute settlement.[57]

Of course, as always, there is a risk that by presenting three prominent examples, one might be taken to imply that these are the rule. It should therefore be underlined that in most cases, ICSID tribunals reach consistent decisions. Yet, even if they are exceptional, the instances of inconsistent decisions are noteworthy. They would seem to be more than occasional aberrations occurring within any system of law. Given the popularity of ICSID proceedings, their number is unlikely to decrease in

50 For subsequent decisions on the scope of umbrella clauses see the (non-ICSID) award, in: *Eureko v. Poland*, Partial Award on Liability of 19 August 2005; and the ICSID decision in *Noble Ventures v. Romania*, Final Award of 12 October 2005, both available on the internet: http://www.investmentclaims.com/oa1.html.

51 *Crawford*, Comment, Transnational Dispute Management 2/2005, 25.

52 *Myers, Inc. v. Canada*, First Partial Award of 13 December 2000 (UNCITRAL), available on the internet: http://www.investmentclaims.com/oa1.html.

53 *Metalclad Corporation v. Mexico*, Award of 30 August 2000 (ICSID), available on the internet: http://www.investmentclaims.com/oa1.html.

54 *Pope & Talbot Inc. v. Canada*, Award of 10 April 2001 (UNCITRAL), available on the internet: http://www.investmentclaims.com/oa1.html.

55 See *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1578-1581 for references.

56 *Myers* (foonote 52), para. 263.

57 For an attempt to influence the matter see the interpretative note issued by the NAFTA Free Trade Commission: 'Notes of Interpretation of Certain Chapter 11 Provisions' (31 July 2001), available on the internet: http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

the future. What is more, inconsistent decisions are clearly visible in a system now increasingly moving towards transparency and greater public scrutiny.[58] Since they will usually concern similar provisions found in different but similarly-phrased treaties, the contradiction between decisions will also be particularly evident. It remains to be seen whether the problem is a fact of life with which investors and States have to put up, or whether it could be remedied by the establishment of an appeals facility.

2. Is Inconsistency a Problem?

Inconsistent decisions need not necessarily be considered a problem. At least three arguments might suggest that it is not.

- *First*, one might take what might be called an "individual approach" to investment dispute resolution, and argue that the first task of a tribunal really is to solve the case rather than to worry about implications. This approach draws attention to one of the specific features of arbitration as opposed to institutionalised adjudication. Indeed, the dispute settlement system established under the ICSID Convention (or the Additional Facility Rules, for that matter), is there for the parties, and not for interested observers keen on systemic consistency. Yet, notwithstanding its correct starting-point, the individual approach is simplistic. It neglects that arbitration within the ICSID system is not purely *ad hoc*, but functions according to institutional rules laid down in the ICSID Convention and Rules. Perhaps more importantly, it ignores that – at least in practice – the ICSID dispute settlement has developed into a system characterised by personal continuity between different panels, frequent references to earlier awards (both in pleadings and awards), and intense peer discussion requiring arbitrators to justify deviations from previous decisions.[59] The day-to-day functioning of the ICSID system therefore defies the premises of the individual approach. Lastly, that approach also ignores that consistency also benefits the parties (and may be expected by them), as it reduces the uncertainty inherent in arbitral proceedings.
- *Second*, one might argue that with the large number of pending investment cases, some degree of inconsistency is normal.[60] Just like the first, this second argument proceeds from a correct starting-point, but is ultimately unconvincing. Of course, one could hardly expect arbitral tribunals to function like robots producing identical results in different cases – especially in a system of decentralised dispute settlement rejecting the concept of binding precedent and based on

58 A point stressed by *Gill* (footnote 46), Transnational Dispute Management 2/2005, 13.
59 Cf. also *Wälde* (footnote 26), 77.
60 *Gill*, Transnational Dispute Management 2/2005, 12 *et seq*.

tribunals on an *ad hoc* basis.[61] More generally, one might say that ICSID dispute settlement lacks 'hard' mechanisms for forcing tribunals to arrive at consistent decisions. But again, this does not mean that inconsistency in ICSID dispute settlement was unproblematic. Very simply, it is submitted that while some degree of inconsistency has to be accepted as normal litigation risk, the present degree of inconsistency is no longer a normal fact of life. Of course, there are few objective criteria measuring "normal" degrees of inconsistency. Yet, it may be helpful to compare ICSID experience to that of other dispute settlement institutions. True, those other bodies have also had to cope with inconsistent decisions. In public international law, for example, the ICTY's *Tadic* decision[62] caused an outrage, because it deviated from the ICJ's standard of attribution established in the *Nicaragua* case.[63] But despite the number of international tribunals, and the host of issues addressed by them, *Tadic/Nicaragua* has really been the one and only high-profile inconsistency.[64] In contrast, even on the basis of the few examples referred to, we can say that investment tribunals openly disagree; they do so frequently, and they do so on a variety of issues. The level of inconsistency reached in investment arbitration seems to be more than a fact of life.

- But there may be yet another reason explaining this high degree of inconsistency. It has to do with the fragmentation of substantive international investment law, and the dominance of specific investment treaties in particular. When applying treaty rules and arriving at different results, so the explanation runs, ICSID tribunals might simply give effect to the differing treaty standards – one might say that, fragmented as it is, investment law simply cannot be interpreted consistently. To take an example, while nearly all BITs prohibit expropriation, they need not all define expropriation in an identical way. If this were the case, inconsistent decisions would not be problematic, but rather to be welcomed. Once more, this argument highlights one of the specific features of investment law. It also enables us to distinguish between different types of inconsistencies. Clearly, it is more problematic for tribunals to interpret one and the same norm inconsistently, as happened with Art. 1105 NAFTA, or to give contrasting decision in *one* case (Lauder) than to interpret two similar, but different provisions (such as two umbrella clauses) differently.[65] However, this does not explain away the problem either. For once, notwithstanding the fragmentation of substantive investment law, there are concepts of general application. A tribunal

61 *Crawford*, Comment, Transnational Dispute Managemant 2/2005, 8 ; *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 9.

62 ICTY, Case IT-94-1, *Prosecutor v. Tadic*, ILM, vol. 38 (1999), 1518 (paras. 116-145).

63 ICJ Reports 1986, 14, 62-65 (especially paras. 109 and 115).

64 For a detailed treatment of the problem of fragmentation see e.g. *Buergenthal*, Proliferation of International Courts and Tribunals: Is it Good or Bad? Leiden Journal of International Law 14 (2001), 267; *Oellers-Frahm*, Multiplication of International Courts, Max Planck UNYB 5 (2001), 67 *et seq.*

65 *Crawford*, Comment, Transnational Dispute Management 2/2005, 25.

asked to interpret an umbrella clause will of course be guided by that clause's wording. But it will also proceed on the basis of its understandings of general conflict principles (such as the lex specialis rule), or of presumptions in favour of or against a specific interpretation. Even where the norm in question is treaty-specific, a tribunal interpreting it thus will operate on the basis of general concepts. It appears that inconsistent decisions such as the *SGS* or *Lauder* cases simply did not turn on the specific wording of a given treaty, but were decided because tribunals approached these general questions differently.[66] To sum up on this point, despite the various arguments advanced by commentators, there is indeed a problem of inconsistency. This leads to the final question: Could an appellate body solve it?

3. Could an Appellate Body Solve the Problem?

At first sight, the answer plainly to this question is in the affirmative. Within many national legal systems, authoritative pronouncements by highest courts often put an end to long-term disputes, between district or regional courts. Similarly, the WTO Appellate Body is widely credited for having rendered dispute settlement in world trade law coherent and predictable. Why, then, to give but one example, should an appellate investment court not authoritatively, determine the proper interpretation of regularly-worded umbrella clauses? While that prospect is indeed appealing, one major problem remains: It must also be stressed that not all appellate systems are likely to render investment law more consistent. Instead, the consistency argument presupposes that the future appeals facility would be established in a particular way. Three specific features can be distinguished.

- First, as a minimum requirement, there would have to be one single appeals facility.[67] As has been noted above, it would be relatively easy for States to agree on a right to appeal under specific treaties. It has also been shown that these treaty-specific appeals could either be handled by one single appellate structure, or by different appellate structures established under the different treaties. If States agreed on various appellate structures for different treaties (such as BITs or multilateral investment treaties), these could admittedly exercise a sane influence on investment law *under that treaty.* With respect to some, widely applicable treaties, this might already be some advantage – for example, a NAFTA appellate investment facility might consolidate the inconsistent case-law on NAFTA standards of protection. But from an ICSID perspective, this would be rather counter-productive, as other appellate structures (for example, an appellate body established under the Energy Charter Treaty) could reach different re-

66 *Franck* (footnote 11), Fordham Law Journal 73 (2005), 1563 *et seq.* and 1569 *et seq.*
67 Cf. also *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 8 (10).

sults.[68] This would add, rather than reduce, uncertainty, and would further fragment dispute settlement under the ICSID system.[69]

- Second, the consistency argument depends on the comprehensiveness of the would-be appellate system. It would not be sufficient for different investment treaties to envisage recourse to one and the same single appellate institution. Rather, that appellate institution would be best suited to bring about consistency if it was competent to hear appeals in *all* investment disputes. The reason for this is that, given the decentralised character of dispute settlement, appellate decisions would first and foremost have to influence subsequent arbitral awards. On that assumption, an appellate decision determining the meaning of an umbrella clause would have good chances of being followed by subsequent tribunals if these tribunals' awards were also subject to appellate review (by the same appellate institution that had rendered the first appeals decision). The situation might be different if the subsequent first-level arbitral tribunal called upon to interpret and apply the umbrella clause would not be part of the ICSID appeals system. Of course, the first-level tribunal could still be persuaded to follow the previous appellate decision – just as presently, ICSID tribunals can of course opt to follow previous arbitral decisions. However, it seems that only the possibility of appeal would really increase the likelihood of consistent decisions. In short, in order to bring about consistency, and to modify the present situation (in which tribunals *can* opt for consistency, but at times do not seem to do so), the future appellate structure would have to be comprehensive, or at least competent to hear appeals in a large majority of cases. In contrast, systems of piecemeal appeal would probably produce no more than piecemeal consistency.
- Third, the consistency argument also favours a specific organisational set-up of the future appeals facility. Even if there was a single and comprehensive appellate structure, the appellate institution would probably have to be organised as standing permanent body, or at least composed of members drawn from a rela-

68 The point was made very clearly by *Sheppard* and *Warner* (Editorial Note, Transnational Dispute Management 2/2005, 3 [4]): "If appellate bodies are established on a particular rather than universal basis, this runs the risk of undermining the reasons for establishing such a system in the first place." See also *Bishop* (footnote 32), Transnational Dispute Management 2/2005, 8 (10): " I would suggest that if we wind up with multiple appellate bodies, as opposed to a single appellate body, that much of the reason underlying the need for an appellate body is going to be undermined."

69 See also the ICSID Discussion Paper (footnote 1), para. 23: "If, however, multiple appeal mechanisms are to be established, ICSID might best abstain from pursuing the creation of an Appeals Facility as it might otherwise only add to the number of appeal mechanisms."

tively small roster of permanent members.[70] Once more, the matter admittedly involves a certain degree of speculation. Yet, experience with the present ICSID dispute settlement system suggests that consistency requires a certain degree of personal and institutional continuity. The point may be illustrated by reference to annulment applications under Article 52 ICSID Convention. At present, annulment is – in the terminology used here – based on a single and comprehensive system, as all annulment applications are handled by ICSID annulment committees governed by Article 52, and as all awards are in principle subject to annulment.[71] Still, a quick glance at cases such as *Klöckner, Vivendi* or *MINE* shows how differently annulment committees have interpreted their task.[72] Much suggests that this difference is largely due to the lack of personal continuity. Had there been, under Article 52, a standing annulment institution, it seems safe to predict that there would not have been such vast differences between the different generations of annulment decisions. Conversely, the relative consistency of WTO Appellate Body jurisprudence (or of ICJ or ITLOS jurisprudence, to take examples of judicial institutions typically acting as first-level courts) is in large measure due to the personal and institutional continuity of the respective bodies. The lesson to be drawn from this experience is that if indeed, ICSID appellate jurisprudence should bring about consistency, it should best be conferred upon a permanent, standing institution composed of a small number of arbitrators.[73]

4. Interim Assessment

The preceding considerations significantly affect the force of the consistency argument. Following the line of argument set out above, one might say that a plurality of appellate facilities would probably do more harm than good. A piecemeal appellate institution with non-comprehensive competence would probably do little harm, but not much good either. (Although of course much may be a question of degree: 90% appealibility would be non-comprehensive in theory, but would go quite some way in fostering consistency, while 20% would not.) Lastly, in order to bring about con-

70 Not surprisingly, such an approach (which clearly follows Article 17:3 of the WTO DSU) is indeed suggested in the ICSID Discussion Paper (note 1): see Annex, para 5: "Such a set of ICSID Appeals Facility Rules could provide for the establishment of an Appeals Panel composed of 15 persons elected by the Administrative Council of ICSID on the nomination of the Secretary-General of the Centre. The terms of the Panel members would be staggered. Eight of the first 15 would serve for three years; all others would be elected for six-year terms. Each member would be from a different country. They would all have to be persons of recognized authority, with demonstrated expertise in law, international investment and investment treaties."

71 See *supra*, section B.I.

72 *Ibid*.

73 *Legum*, Visualizing an Appellate System, Transnational Dispute Management 2/2005, 64 (66).

sistency, the appeals facility would probably have to have very few members, and function on a permanent basis. These considerations are not aimed at discarding the consistency argument altogether. As a matter of principle, it remains valid, and strongly militates in favour of reforming the present system. However, it has also been shown that in order to foster consistency, the ICSID system would have to opt for a quite particular form of appeals structure, and one that is not likely to be easily agreed on. Lastly, the fragmentation of substantive investment law means that even an appeals institution fulfilling these requirements would not solve the problem of inconsistency altogether. In short, the consistency argument is much qualified by both practical considerations and the specific features of investment law.

II. An Appellate System Would Be More Likely to Produce Correct Decisions

The hope for consistency is one argument in favour of reforming the present ICSID system. But there is a more basic promise of introducing a second level of dispute settlement. Having two levels of dispute settlement could enhance the prospects of correct decisions – one might call this the ‘accuracy' or 'correctness argument'. Its idea is that an investment appeals court is more likely to 'get it right' than ICSID panels of arbitrators at present. This in turn might be more important to investors or States than the time and cost spent during litigation – as *V.V. Veeder's* observation suggests:

"Of course, for the investor or the state, the final successful arbitration award is always an undisguised blessing. […] But, for the unsuccessful investor, an adverse final award is obviously adversely final and the result or reasoning of the award can act as a defect of precedent for other investors facing the same issues. Thus finality may be less desirable for the investor and investment arbitration than getting the answer right."[74]

It is difficult to take issue with the proposition that arbitral tribunals should render correct decisions, and therefore proposals aiming at correct decisions should be welcomed. But would an appellate system really increase that possibility? At a general level, the answer is probably yes. The investment appellate body could focus on the issues that divide the parties, and it would have the benefit of having before it one fully-reasoned decision. On the other hand, there is of course no guarantee. But maybe more important than these general considerations is whether the ICSID system needs an appellate level to have bad decisions corrected. This question of course can hardly be answered comprehensively – since a comprehensive answer would presuppose an exhaustive assessment of ICSID jurisprudence. Yet, it may be helpful to approach it from the perspective of ICSID's clients. Does their conduct provide evidence for a general dissatisfaction with the present system based on one level of dispute settlement? It is submitted that the answer to this question is "no". Of course,

74 Transnational Dispute Management 2/2005, 6.

the decision of some States to draft investment treaties envisaging an appellate structure is an important factor. However, it is a factor that has to be put into perspective. From a more general angle, this State practice is probably less impressive than it seems (or than the ICSID Secretariat suggested in its Discussion Paper). It has to be contrasted to a number of other factors which are clear evidence of trust placed in the ICSID system *in its present form.* These other factors include

- the still increasing number of States ratifying the Convention and concluding investment treaties with ICSID jurisdictional clauses;
- the willingness of investors to bring ICSID claims;
- the readiness of States to comply with ICSID awards;

These factors are not intended to suggest that everything was perfect. However, they suggest that in the view of most parties, the present system with one level of dispute settlement can still be trusted. As has been shown,[75] it is a system that was designed after careful deliberation, a system that had to strike a balance between the need for correct decisions, and the interests of finality, i.e. time, cost and trust in panellists. On balance, the preceding considerations do not show any sustained and wide-spread desire among ICSID participants to move away from that system, towards an appellate structure. Proposals for a reform thus rest on abstract propositions about the relative advantages of appeals structures generally, which cannot be simply applied to the ICSID system. With respect to investment law, it seems that the drafters' decision to place trust in a single level of arbitration, and to emphasise the need for a speedy resolution of disputes, still holds true today. As a consequence, the 'accuracy argument' is not really convincing.

III. An Appellate System Would Increase the Authority of ICSID Awards

Even if it is not strictly called for in order to bring about consistency, or to eliminate errors, setting up an appeals facility may have other positive effects. According to some, it might increase the authority of investment awards. For example, *Audley Sheppard* and *Hugo Warner*, noting the limited legitimacy of investment arbitration, argued that "the presence of an appellate mechanism" – which they held "should be as authoritative as possible" – "may partially solve this problem".[76] Few of course would dispute that investment awards lacking authority are problematic. In this respect, the basic rationale underlying the 'authority argument' seems appealing. Still, it is another question whether the introduction of an appeals facility would truly enhance the authority of investment awards. In this respect, it is necessary to distinguish between ICSID Convention awards on the one hand, and Additional Facility awards on the other.

75 *Supra*, section II.
76 *Sheppard/Warner* (footnote 68), Transnational Dispute Management 2/2005, 4.

1. ICSID Convention Awards

ICSID Convention awards could gain in authority because an appellate body rendering them might enjoy a higher degree of eminence than first-level tribunals. This would not necessarily be the case, but would not be unlikely if the appellate body was set up as a permanent institution composed of highly-respected lawyers, and if its jurisprudence over time earned the respect of the investment community. Experience with WTO law but also with national legal systems indeed suggests that standing higher-level judicial bodies over time can acquire a certain status as institutions, which in turn increases the authority of their pronouncements.[77] The same would not be unlikely to happen in investment arbitration, if one particular form of appellate institution (namely a standing body) was created. This standing appellate body could over time gain an institutional respect that *ad hoc* panels of arbitrators could not acquire. Seen from this perspective, the creation of an appeals facility might have a positive effect on the authority of investment awards, including awards rendered under the ICSID Convention. Just as with respect to the accuracy argument, the real question however is whether this potential would justify a major overhaul of the presently decentralised system. The answer to this question does not only depend on the reform's potential effects, but on whether it is necessary. It must therefore be asked whether at present, without an appeals facility, investment awards rendered under the ICSID Convention lack the required authority. This in turn depends on legal provisions determining the status of awards, as well as on compliance in practice.

As far as legal provisions are concerned, awards leave little to be desired. Article 53 of the Convention declares them to be binding, while Article 54 equates them to decisions of highest national courts. As has been noted already, the Convention deliberately rules out any possibility of national court review; instead it provides an exceptionally strong enforcement mechanism.[78] When looking at the letter of the law, ICSID Convention awards thus could hardly be more authoritative than they already are at present.

Ultimately, however, an award's authority depends on whether it is complied with in practice. In this respect, investment awards also perform rather well. Of course, States have often expressed dismay when required to pay large sums of damages; some have also voiced concern of a more general nature, and have threatened to leave the system of investment law altogether.[79] These warnings should not be ignored. But they also have to be put in perspective. From a broader angle, it seems that States' criticism of the system has remained exceptional, and has not been fol-

77 See already *supra*, section D.I.4.

78 *Supra*, section B.I.

79 See notably Argentina's threats to re-admit a review of ICSID awards by national courts, and to re-introduce the Calvo and Drago clauses: cf. *Alfaro*, ICSID Arbitration and BITs Challenged by the Argentine Government and its Supreme Court, Oil Gas and Energy Law (OGEL) Vol. 2, Issue 4, 2004, available on the internet: http://www.gasandoil.com/ogel.

lowed up by concrete actions. Certainly when compared to other forms of international dispute settlement, compliance with investment awards remains largely unproblematic, despite the high stakes involved. Paraphrasing a famous dictum about compliance with international law generally, it seems fair to say that 'almost all States comply with almost all investment awards almost all the time'.[80] In fact, notwithstanding a few problematic cases of enforcement,[81] all ICSID Convention award have so far been complied with; there is thus no investment law equivalent to famous inter-State instances of non-compliance such as the ICJ *Nicaragua* decision.[82] Also, investment awards have usually[83] been complied with promptly. Again, compared to other international bodies' track record, there is no equivalent to the decades it took Albania to accept the ICJ's *Corfu Channel* decision,[84] or Turkey's year-long refusal to pay Mrs. *Loizidou*.[85]

The preceding paragraph should not be taken as a plea for complacency. Of course, even systems with good compliance records can break down, and lose their authority. What is important to note is that despite repeated warnings, and notwithstanding the high stakes involved, the ICSID system *is* a system with a good compliance record. Legally, the Washington Convention imbues awards with a high degree of authority. In practice, States have complied with awards. On that basis, it does not seem necessary to introduce an appeals system in order to increase the authority of ICSID Convention awards.

2. Additional Facility Awards

As far as Additional Facility awards are concerned, the different considerations set out in the last section equally apply. In particular, it is worth pointing out that despite the possibility of national court review, Additional Facility awards also have a good compliance record so far. Still, the aftermath of the *Metalclad* award[86] shows the potential for conflict. Figuratively speaking, the British Columbia Supreme Court decision[87] may have been a shot over the bow, signalling national courts'

80 Cf. *Henkin*, How Nations Behave (2nd edn., New York, 1979), 47: "Almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time."

81 Namely the *Benvenuti*, *SOABI*, and *LETCO* cases. On compliance in the former two see the information provided in *Schreuer*, The ICSID Convention (footnote 8), Article 54, MN 50-60.

82 ICJ Reports 1986, 14.

83 For exceptions, see notably the cases referred to in footnote 81.

84 ICJ Reports 1949, 4.

85 The various awards in the case are available on the internet: http://cmiskp.echr.coe.int/tkp197/view.asp?item=3&portal=hbkm&action=html&highlight=loizidou&sessionid=6636633&skin=hudoc-en.

86 *Supra*, footnote 54.

87 Decision of 2 May 2001, [2001] SCBC 664, available on the internet: http://www.investmentclaims.com/oa1.html.

unwillingness simply to accept investment awards at face value. Of course, *Metalclad* itself was controversial, and it is worth pointing out that the shot went over the bow rather than hitting the ship. However, the proceedings show that investment awards rendered outside the ICSID Convention are vulnerable, and do not enjoy the protection, or authority, which Arts. 53-54 confer upon Convention awards.

According to some, the establishment of an appeals mechanism might provide an opportunity to remedy this problem. In the words of *Daniel Price*, "if we are going to have an appellate mechanism then it […] has to displace completely the role of national courts presently exercised under the New York convention".[88] In other words, Additional Facility appellate awards would be as immune from national court review as ICSID Convention awards. It is not quite clear how that proposal should be implemented – probably best by including a waiver clause in the relevant jurisdiction-conferring instruments. But it is clear that it would enhance the status of investment arbitration and remedy one of the weaknesses of Additional Facility awards compared to awards rendered under the ICSID Convention. In that respect, one might indeed be tempted to say that the creation of an appeals facility could increase the authority of investment awards rendered outside the ICSID Convention. However, it should also be pointed out that this would not be an automatic consequence, but depend on the willingness of States to take the extra step of "elevating" Additional Facility awards, as far as their immunity from national court review is concerned, to the level of ICSID Convention decisions. Whether States are willing to take that step, and whether they would be willing to do so in each and every treaty envisaging an appellate investment decision, is another matter.

3. Interim Assessment

To sum up, the 'authority argument' provides limited support for the establishment of an ICSID appeals facility. A permanent investment appellate institution, possibly modelled along the lines of the WTO Appellate Body, might gain an institutional prestige increasing the authority of its decisions. With respect to Additional Facility awards, States might also be willing to sacrifice national court review of such appellate awards. Both factors are speculative though: States need not necessarily recognise the higher status of appeals decisions, and institutional prestige is not gained lightly. In any event, investment appeals in practice do not really suffer from serious problems of authority, as compliance with them is very good. Also, at least with respect to awards rendered under the ICSID Convention, it is difficult to imagine how awards, as a matter of law, could be more authoritative. Lastly, one should not forget one potential drawback of appeals systems, which may be seen as the 'authority argument' turned on its head. As has been noted, while potentially increasing the

88 *Price*, US Trade Promotion Legislation, Transnational Dispute Management 2/2005, 48; similarly *Legum* (footnote 73), Transnational Dispute Management 2/2005, 64.

authority of some decisions, a move towards a two-tiered system of dispute settlement risks undermining the authority of the first level decision.[89] Even if a two-level process of dispute settlement eventually produced decisions that were more authoritative then the ones presently rendered, this increase in authority would have to be measured against a loss of authority of the first level awards. On balance, therefore, the 'authority argument' provides only rather ambiguous support for the creation of an ICSID appellate structure.

IV. Interim Conclusions

The preceding sections have examined a rather heterogeneous range of arguments put forward to support the establishment of an ICSID appeals facility. They have shown that a reasonably good case for introducing an appeals structure can be made. Primarily, this case rests on what has been labelled the 'consistency argument', i.e. the hope that an appeals facility would render investment law more coherent, and would put an end to the worrying series of inconsistent decisions by ICSID and other investment tribunals. In contrast, other arguments allegedly supporting the establishment of an appellate structure are of lesser value. In particular, it is a matter for speculation whether a two-tiered system of dispute settlement would produce better, or more authoritative decisions. In any event, judging from the conduct of ICSID participants, there do not really seem to be serious problems of authority or accuracy within the present system.

Whether this mixed record is sufficient to overcome the various drawbacks of a reform may be a matter of perspective – depending on which the glass may be considered half-full or half-empty. As has been shown, the drawbacks of a reform (some certain, some speculative) weigh rather heavily: not so much because of abstract concepts such as finality, but because the possibility of appeals would make investment proceedings more expensive, would prolong the period of uncertainty between the application and the eventual decisions and could de-value the authority of first-level awards. Perhaps most importantly, anyone considering the opposing arguments should bear in mind that in order to achieve the desired results, one would have to opt for a specific form of appeals facility: for the various reasons explored above, a meaningful reform of the system would have to seek to establish a single permanent institution with comprehensive competence. In contrast, treaty-specific appeals jurisdictions, possibly even organised in multiple fora, would probably (at least from an ICSID institutional point of view) increase rather than alleviate problems.

In the light of these considerations, the better arguments suggest that the glass is half-empty. The case for establishing an appeals facility is certainly not compelling. Given the difficulties of a reform, and the range of ensuing consequential problems

89 Section C.II.

which the present paper has not even touched upon, one should probably not risk paralysing a still-functioning system by seriously engaging in a far-reaching institutional reform. On balance, the benefits seem too speculative, the institutional costs too high, and the chances of success too slim.

D. Alternatives

So far, this paper has focused on the rather drastic reform proposals put forward by the ICISD Secretariat in its October 2004 Discussion Paper. The preceding section suggests that even with more time and a more methodical discussion, that drastic reform should not be pursued. Admittedly, the cautious approach thus advocated may also cause problems – experience suggests that often, postponing reforms is as dangerous as an over-ambitious reform gone awry. To avoid that problem, a number of alternatives to an appellate structure will be briefly examined in the following. These alternatives are all aimed at remedying the most problematic feature of ICSID dispute settlement, namely that of inconsistent awards.

I. Critical Debate of Inconsistent Awards

The most obvious of the various alternatives examined in the following is a plea for a critical peer review of inconsistent awards. This review should be aimed at highlighting the risks of inconsistent awards; it should encourage tribunals to avoid outright contradictions in their respective reasoning, or at least to explain contradictory approaches with reference to the specificities of the case before them. While obvious, these proposals may indeed be helpful. Experience with inter-State dispute settlement suggests that a professional debate about the risks of fragmenting international law through inconsistent decisions does exercise a moderating influence on tribunals. To come back to the public international law example referred to earlier, it bears underlining that since the beginning of the critical debate about inconsistent decisions (triggered by the *'Tadic-Nicaragua* conflict'), there do not seem to have been any further instances of serious conflicts between different international tribunals. Of course, the reasons for this healthy development are difficult to re-establish, but it does not seem to be far-fetched to suggest that the existence of a critical debate may have been a force for the good. Based on that experience, one might hope that "transparency, publication and informed and professional peer discussion"[90] would reduce the number of inconsistent investment awards. In that respect, the on-going discussion, among ICSID officials, ICSID clients, arbitrators, counsel and academics, about the coherence of investment law, as well as the general trend towards a more rigorous scrutiny of ICSID decisions may have a sane influence on future

90 *Wälde* (footnote 26), Transnational Dispute Management 2/2005, 77.

ICSID panels.[91] They might be part of an evolution of investment law, a process eventually leading to "the development of a common legal opinion of *jurisprudence constante,* to resolve the difficult legal questions [dividing different arbitral tribunals]".[92]

II. Consolidating Cases

As noted above, inconsistent decisions may simply be a consequence of decentralised, *ad hoc* dispute settlement by different panels of arbitrators. Not surprisingly, then, one way of avoiding inconsistent decisions may be to consolidate cases. Admittedly, consolidation has a number of drawbacks. The most obvious is that it only becomes an option if two or more proceedings concern the same subject-matter.[93] Yet, the Argentine experience suggest that this does happen. At least for some types of conflicts, consolidation might be a way out of the dilemma. In fact, it would seem to be a rather attractive option.[94] It is an option already available under the present system, which does not prevent parties from joining proceedings and appearing as parties in the same interest. Alternatively, parties remain free to consolidate cases in an informal way, by agreeing to nominate the same arbitrators – which is what happened in some of the recent proceedings concerning the Argentine's privatisation of the gas industry.[95] If this is done, formal or informal consolidation would seem to provide very effective remedies against inconsistent decisions. As a rule, they would also be likely to save money and time. Of course, given its drawbacks, it will not solve the problem of inconsistent decisions altogether, but at least it may alleviate it to some extent, and thus prove a helpful alternative.

91 *Wälde*, *ibid.*; similarly *Gill* (footnote 46), Transnational Dispute Management 2/2005, 13.

92 Cf. *SGS-Phllipines* (footnote 45), para. 97.

93 For an interpretation of what is meant by the general requirement of "same subject-matter" see *Crivellaro*, Consolidation of Arbitral and Court Proceedings in Investment Disputes, 4 Law and Practice of International Courts and Tribunals (2005), 371 (394 *et seq.*).

94 See also *Blackaby*, Testing the Procedural Limits of the Treaty System: The Argentinean Experience, Transnational Dispute Management 2/2005, 19, and the brief observation by *Wälde* (footnote 26), Transnational Dispute Management 2/2005, 76.

95 Namely *Camuzzi International S.A. v. Argentine Republic*, Case No. ARB/01/3, and *Sempra Energy International v. Argentine Republic*, Case No. ARB/02/16. In both cases, the tribunal was composed of *Francisco Orrego Vicuna*, *Marc Lalonde* and *Sandra Morelli Rico*. The concurrent decisions on objections to jurisdiction are available on the internet: http://www.worldbank.org/icsid/cases/awards.htm. For brief information on other informally consolidated cases see *Blackaby* (footnote 96), Transnational Dispute Management 2/2005, 18-19.

By the same token, States might consider formulating ICSID disputes as inter-State disputes and submit them to the United Nations "principal judicial organ"[96], the International Court of Justice (ICJ). This is an option which so far has not been pursued, but which is explicitly foreseen in Article 64 of the ICSID Convention. Just as consolidating cases, turning to the ICJ does not offer a proper substitute for an appeals system. In fact, Article 64 only establishes the Court's jurisdiction over inter-State disputes "concerning the interpretation or application of th[e] [ICSID] Convention". The drafting history clearly shows that the provision was not to be used to introduce a form of appeal to the ICJ. What is more, according to Article 34 of the ICJ Statute, disputes would have to be formulated as disputes between two States. It would thus require some creative legal argument to present disputes about specific investment treaties (such as the precise interpretation of BIT standards) as "ICSID disputes" coming within the ICJ's jurisdiction.

Within those limits however, it is submitted that Article 64 of the Convention could play a helpful role, and deserves more attention than it is usually given. There are good reasons to assume that ICJ judgments on matters of investment law are more likely to be generally accepted than decisions by three member *ad hoc* tribunals or committees. This first of all has to do with the Court's standing: the "World Court" is a venerable institution composed of 15 permanent members representing "the main forms of civilization and the principal legal systems of the world."[97] Its special status is reflected in the frequent references, in ICSID awards, to ICJ judgments,[98] but also in the broad acceptance of important ICJ decisions on issues such as diplomatic protection or the nationality of corporations. Contrary to *ad hoc* arbitral bodies, the Court thus possesses a considerable institutional authority, which would imbue its pronouncements on investment law matters with a considerable authority. The solemn atmosphere and length of ICJ proceedings might add to this; both would mean that an eventual decision would be rendered only after detailed argument and would be well considered. In short, there might be some virtue in using the ICJ to clarify particularly important matters of investment law.

96 Cf. Art. 92 UN Charter.

97 Cf. Article 9 ICJ Statute.

98 A particularly prominent example is the jurisdictional award in *CMS*, which extensively discusses the ICJ's *Gabcikovo Nagymaros case*, and also refers to the *Nicaragua* and *ELSI cases*: *CMS Gas Transmission Company v. Argentina*, Decision on Jurisdiction of 17 July 2003, paras. 309, 313, 330, 339, 371, 372.

IV. A Reference Procedure Along the Lines of Article 234 TEC

Finally, a reference procedure along the lines of Article 234 TEC[99] might be yet another alternative to an appeals facility.[100] Under that provision, national courts can refer certain matters of law to the ECJ for decision.[101] When answering an Art. 234 reference, the ECJ is not acting as an appellate court, but simply ruling on a point of EC law. It remains for the national court to use this information to decide the case. Still, experience within Europe suggests that the reference procedure is one of the ECJ's most powerful tools in ensuring the uniform application of EC and EU law. Of course, this experience cannot simply be used as a blueprint for investment arbitration. Unlike under Article 234 TEC, references would have to be made not by national courts, but by arbitral tribunals. In many respects, the institution competent to decide on references would face problems similar to those of an appellate institution: for example, one would have to agree on the scope of review, or on the types of questions that could be referred to it, and on its composition. In addition, one would have to decide which parts of its rulings should bind normal ICSID arbitral tribunals, whether this binding force should also extend to subsequent cases, and whether ICSID tribunals could be under an obligation to make reference. In short, the problems of implementation would be enormous. Still, introducing a reference procedure would have one decisive advantage over plans to establish an appeals system: it would not conflict with Art. 53 of the ICSID Convention. Even with a reference system, ICSID awards (following a reference decision) would not be "subject to any appeal". There would thus be no need for an amendment of the ICSID Convention; in contrast, the reference system could be established through an amendment of the ICSID Rules.

99 In its entirety, the provision runs as follows: "The [European] Court of Justice shall have jurisdiction to give preliminary rulings concerning:
(a) the interpretation of this Treaty;
(b) the validity and interpretation of acts of the institutions of the Community and of the ECB;
(c) the interpretation of the statutes of bodies established by an act of the Council, where those statutes so provide.
Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the [European] Court of Justice to give a ruling thereon. Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the [European] Court of Justice."

100 For brief comments in that regard see e.g. *Kaufmann-Kohler*, Annulment of ICSID Awards in Contract and Treaty Arbitrations: Are there Differences?, in: *Gaillard/Banifatemi* (footnote 8), 189 (221).

101 For details on Article 234 see e.g. *Tridimas*, Knocking on Heaven's Door: Fragmentation, Efficiency and Defiance in the Preliminary Reference Procedure, Common Market Law Review 40/1 (2003), 9-50; *Dauses*, Das Vorabentscheidungsverfahren nach Artikel 177 EG-Vertrag (2nd edn., München, 1995).

Compared to the other options discussed in the present section, an ICSID reference procedure is certainly the most ambitious alternative to an appeals system. Unlike ICJ references or the consolidation of cases, it would require an amendment of ICSID's institutional set-up. However, its establishment would be less cumbersome than that of an appeals system proper.

E. Concluding Observations

The present paper suggests that there are no compelling reasons to move towards an investment appellate structure. The drafters' decision to set up ICSID as a single-level system of dispute settlement remains plausible today. This system, based on decentralised dispute resolution by *ad hoc* tribunals, has very few instruments to prevent inconsistent awards, which is a serious problem. However, this problem should not be addressed by establishing an appellate structure. Instead, there may be virtue in simply highlighting the risk of inconsistent decisions, or to make use of two existing alternatives: consolidating cases, or seeking ICJ decisions. If this proves insufficient, and if a major reform of the present system becomes unavoidable, then it would be preferable to opt for an ICSID reference procedure along the lines of Article 234 TEC.

A Development Perspective to the Introduction of an Appellate Process in International Investment Arbitration

Comment by *Asif H. Qureshi*[*]

I am very grateful to the organisers of the conference for having given me the opportunity to comment on Dr *Tams's* paper. My sincere thanks for the warm hospitality I received in Frankfurt.

I am very impressed by Dr *Tam*'s paper - which excels in being very informed, very considered but most of all very measured. Generally, I would make three observations.

First, it seems to me that deconstructionists would have much to say about proposals for reform in the international investment dispute settlement system, given that it is largely set against a normative framework that is bilateral, disorganised and non-multilateral. Is it really possible to meaningfully evaluate the arguments for and the obstacles in setting up an appellate facility in the investment sphere, with the objective of providing normative coherence, in circumstances where the multilateral consensus on substantive matters is not very evident. Does this institutional debate not partake of our concerns and preferences with respect to the normative framework of investment? Indeed, is the suggestion for an appellate facility at a multilateral level not an attempt to force an issue on the international agenda - one which has not received the endorsement for being negotiated by a significant constituency concerned with international investment law? In recent history this lack of endorsement has happened twice, first in the context of the negotiations for a Multilateral Investment Agreement (MIA) under the auspices of the OECD, and then under the Doha Agenda within the WTO.

Second, in my opinion it is not possible to engage in constructing dispute settlement mechanisms - without reference to the nature of the underlying normative structure. The case for an appellate facility must be set against the objectives and purposes of the provision of dispute settlement *in the international investment sphere*. It is not possible to de-link institutional building from its substantive sphere and its underpinnings. The objects and purposes of the international investment system along with its normative framework inform the institutions that govern and serve it. The objectives of investment are not confined to the investors' concerns alone. Thus, 'consistency, accuracy and authority' in dispute settlement may be significant reasons for institutional reform - but there are other concerns which may

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seek to trump these considerations - for example human rights, environment and of course the development objectives of the host State.

Third, there is no doubt in my mind that there is a development perspective in the establishment of an appellate process in the investment sphere. This involves ensuring inter alia that:

- the review process facilitates the development objective;
- that the review process reduces or alleviates the burdens that accompany investment liberalisation through the interpretative process;
- that there exist independent, fair and transparent processes in the appellate structure, through for example ensuring effective participation of developing/host countries in the appellate process;
- that the power of multinational corporations is not unduly strengthened through the abusive use of an appellate process;
- that the national legislative 'policy space' developing countries need for their development objectives is not undermined through the introduction of an appellate process;
- that the appellate system does not lead to the multilateralization of bilaterally negotiated agreements; and thereby compromise the flexibility afforded by a bilateral system along with the collective decision of developing countries not to engage in a multilateral system that is not development friendly.

More specifically with reference to some of the main points made in Dr *Tam'*s paper, the following questions are posed. First, is the justification for an appellate system on the basis of 'consistency and coherence' in judicial outcomes not really an argument for moulding a particular kind of 'consistency and coherence' into the disorganised international investment system - given that interpretation in an appellate process is a form of legislation? Is the objection to 'inconsistency' not really a call for normative uniformity? Second, should disparate investment norms necessarily be interpreted identically on the basis of equality, fairness, predictably and reliability? Third, if investment involves and is about ultimately ensuring development - should development not be the overriding consideration in the process of interpretation? Should there not be a strive consistently at better facilitating the 'development objective' and better decisions all round, rather than pursuing a fetish for identity of interpretation? Fourth, will a non-ringed fenced appellate system, set against a disorganised bilateral investment normative framework, not add to uncertainty and complexity - given that the beneficiaries of and parties to bilateral agreements will not be clear as to how ultimately their rights and obligations will be 'coherently and consistently' interpreted, not to mention the added complexity in interpretation arising from such a system? Finally, will an appellate system not lead to further investor bias, by augmenting the capacity of multilateral companies to pursue an appeal?

In conclusion I would agree with Dr *Tams'*s negative assessment of the 'consistency' basis for an appellate system but for different reasons. I would not put it on such a high pedestal as other objectives - particularly the development objective. From a development perspective a treaty specific appeal system is favoured. A principal concern about the efforts for introducing a non-ring fenced appellate system in

the investment sphere is that it seeks to add to the coherence and development of international investment law through a somewhat non-transparent route. Further, the need to inject the development dimension in any proposed appellate system is important. A development friendly appellate system requires in particular a focus on its apparatus of interpretation; on participatory rights and technical assistance.

Inconsistent ICSID Awards – Is There a Need for an Appellate Structure?

Comment by *Richard H. Kreindler*[*]

It is a great pleasure to comment briefly on the excellent presentation and conference paper provided by Dr. *Tams*, entitled "Is There a Need for an ICSID Appellate Structure?" Dr. *Tams* has sought to tackle a thorny question which is of increasing relevance both as a scientific inquiry and as a matter of practical relevance. It affects the everyday life of international investment-related contracts, dispute resolution provisions and subsequent arbitrations.

My brief comments and observations use Dr. *Tams*' paper as a point of departure. They admittedly somewhat transcend the specific content of his own paper, and are organized into four areas of inquiry as follows:

- *First,* Is there a trend in favor of an appellate mechanism in this area?
- *Second,* How may this question be addressed in the ICSID Convention[1] context versus bilateral and multilateral treaty contexts?
- *Third,* What arguments exist for and against an appellate mechanism in this area?
- *Fourth,* What may be said of Dr. *Tams*' specific proposal respecting "reference 0proceedings" and could one contemplate analogous application of Article 1131(2) of the NAFTA[2]?

A. Trend in Favor of Appellate Mechanism

The increase in number and size of investment-related and particularly ICSID Convention-based arbitrations in the last ten and particularly five years – some would term it an onslaught – has led various observers to question whether some form of appellate mechanism may now be called for. These observers include consumers of arbitration, professors, practitioners and arbitrators, and some wearing more than one of these hats simultaneously. The very transparency of many investment-related arbitrations, especially those under the ICSID Convention, has given rise to dis-

* *Richard H. Kreindler,* Attorney Shearman & Sterling LLP, Frankfurt. The original presentation style has intentionally been substantially preserved.

1 Available, *inter alia*, at http://www.worldbank.org/icsid/basicdoc/CRR_English-final.pdf.

2 Available, *inter alia*, at http://www.investmentclaims.com/instruments/NAFTA%20Text%20%20Excerpts.pdf.

crepancies or disconnects, or perceived discrepancies and disconnects. Some have seen these as providing justification for some form of appellate review at a supranational level.

Whether a true trend in this respect has been emerging is difficult to say. Trends with respect to ICSID-related arbitration are sometimes measured by comments in doctrine, sometimes by holdings and dicta in awards, sometimes by observations at conferences and increasingly by web-based exchanges. The sum total of the foregoing does not necessarily suggest, in my mind, a trend in favor of an appellate mechanism.

What it does suggest is that increasing disquiet is emerging in some circles over the discrepancies and disconnects, or perceived discrepancies and disconnects, that may have emerged from one award to the next. These relate to such fundamental issues as the "fair and equitable treatment" standard and other public international law-based measurements which play a role in investment-related contracts, claims and disputes.[3] On another level, it might be claimed that such a trend is in fact already emerging, even at an official or semi-official level. One example of such a manifestation might be the October 2004 ICSID "Discussion Paper on Possible Improvements of the Framework for ICSID Arbitration" (October 22, 2004).[4]

If there is such a trend, is this trend correct? And even if it is not correct, is it irreversible?

Whether such a trend is "correct" cannot possibly be answered in a uniform manner. Indeed Dr. *Tams* himself does not presume to attach a blanket correctness or incorrectness to any such trend. If for no other reason, it is impossible and in any event ill-advised to consider such a trend to be the proper path. The reason is that the factors causing a perceived need for an appellate structure are diverse. They affect only some ICSID matters and not others. They are in part a sign of the times which may change over the next few years.

The supposed need for and lack of uniformity and harmonization which some would see as the justification for an appellate structure may, even if it did exist today, look quite different in five years, with the benefit of further jurisprudence and doctrinal development. And also for that reason, the trend should not be considered irreversible. The need seen by some for harmonization and supra-level control today may be looked at with different colored glasses in the next decade.

3 *See, e.g., Kreindler*, "Fair and Equitable Treatment – A Comparative International Law Approach," presented at the Harvard Law School Conference on "International Investment Law at a Crossroads," March 3, 2006, and *reprinted in* Transnational Dispute Management-TDM, Vol. 3, Issue 3, June 2006.

4 Available*, inter alia*, at http://www.asil.org/ilib/2004/10/ilib041030.htm#d1.

B. ICSID Convention versus Other BIT/MIT Contexts

The focus here is avowedly on ICSID arbitration (both contractual and non-contractual), and not on ICSID Additional Facility[5], NAFTA or other non-ICSID bilateral investment treaty (BIT) or multilateral investment treaty (MIT) bases. Indeed in the overflow of discussion that has emerged regarding the possible need for an appellate structure, it is sometimes neglected that certain of the phenomena which are being experienced in investment-related arbitration, whether for good or for ill, have little or nothing to do with ICSID Convention matters per se. Rather, they are rooted in specific, individually – and often idiosyncratically – drafted and interpreted BITs and MITs.

At the same time, discussion in isolation or ignorance of other investment-related arbitration would be misleading, illusory and counterproductive, so that the ICSID discussion is to a great extent a global discussion. Many, if not most, of the at least publicly accessible ICSID awards which have an influence on the emerging investment-related jurisprudence respecting such matters as expropriation, minimum standards and the like may also be seen as influential in non-ICSID based arbitrations and awards which address essentially the same issues. And in reverse, various non-ICSID based awards which have entered the public domain have been considered by ICSID Convention-based tribunals at least as having a certain precedential influence or weight.

C. Arguments for and against Appellate Mechanism

The arguments for and against an ICSID or supra-ICSID "appellate structure" are already well articulated, and to a great extent evenly balanced. They include the following:

I. First: Predictability

The rationale is that if all ICSID Convention awards were subject to a largely uniform standard and staffing of review and appeal, then both the underlying awards and any appellate decisions would ensure or at least promote greater predictability as to how recurring issues would or should be decided.

5 Available, *inter alia*, at http://www.worldbank.org/icsid/facility/facility.htm.

II. Second: Consistency

At first blush, consistency might be perceived to pose the same issues as predictability, and to be sure they are interrelated. At the same time, predictability is not necessarily a guarantee of consistency.

Consistency is not possible or desirable where a fact-driven analysis demands different results under different circumstances. On some levels, consistency is no more possible in public international law issues, including many affecting investment arbitration, than in commercial disputes, since the result is and should often be fact-dependent.

III. Third: Coherence

While arguably a subset of both predictability and consistency, coherence deserves its own standard and its own discussion, and is surely part of any debate about the need for an appellate structure.

It might be contended that incoherent awards are not likely to foster predictability or consistency. Yet the primary goal of a coherent award is that its reasoning and findings are understandable and defensible internally *inter se*, within the particular factual and legal framework of that dispute, its treaty or contract bases and the evidence adduced.

Thus on the one hand the coherence of an award, particularly in the transparent investment award context, may hinge on both the tenability of the conclusions under the particular factual and legal circumstances on the one hand, and on the tenability of the result vis à vis similarly situated prior awards. At the same time, an internally coherent award may appear to be incoherent when compared with other awards which are perceived as treating the same subject, particularly application or interpretation of the same legal principles or treaties.

IV. Fourth: Transparency

Transparency may be seen as affecting each of the factors already addressed above.

The more transparent or accessible an award or ruling, the more likely it is to attract the attention of judges, arbitrators, parties and counsel in simultaneously pending or future cases. In turn, the more likely it is to precipitate agreement or disagreement in subsequent awards or judgments. This is particularly so if the prior ruling breaks new ground, disagrees with a prior line of precedent or otherwise involves noteworthy participants and/or high stakes legally or commercially. An appellate structure, it is argued, may serve the goal of transparency by subjecting already transparent ICSID decisions to a further transparent scrutiny process.

This is of course assuming that transparency is accepted as a goal of arbitration or at least investment arbitration – which is by no means a uniformly held view.

V. Fifth: Accountability

Like predictability, accountability is somehow fused with the other factors discussed above. At the same time, accountability may be seen as portending greater control, greater circumspection and even greater mistrust of a process which, without some appellate review mechanism, would potentially go off on its own tangent.

Query whether such control and circumspection are possible or desirable. The same might be said of any appellate process whether in civil litigation or in arbitration generally. But it remains that appeal per se, as opposed to challenge or annulment on narrow and substantially procedural grounds, is largely considered anathema to arbitration. Annulment, on the other hand, including the ad hoc annulment scheme as practiced thus far in ICSID arbitration, is already seen as providing a certain measure of accountability.

Those who advocate a further and more elaborate ICSID appellate structure often point precisely to the ad hoc annulment scheme as being a partial failure, and as engendering not more accountability, but actually less. One reason for this view among those who hold it is that the ad hoc annulment scheme by design has been just that, ad hoc. Most conceptions of an ICSID appellate scheme, by contrast, foresee a finite and largely unchanging group of appellate judges or reviewers who, by virtue of their tenure over time, might serve the goal of accountability better than in an ad hoc process where the judges or reviewers are different from annulment to annulment.

This is all by way of presupposing that accountability in investment arbitration is desirable. While arbitrators should not be "unaccountable," it is not an entirely unanimous view that arbitrators chosen for an individual case with a specific seat, specific law and specific rules actually owe any "accountability" to anyone – except of course to the parties, the institution if any, and the courts at the seat in the context of the mandatory norms of due process, equal treatment and other sources of control typically considered to be synonymous with the grounds for opposition to enforcement found in Article V.1 and V.2 of the New York Convention.[6] In the case of a self-enforcing award which is not deemed to be subject to the New York Convention, then accountability is a matter between the arbitrators, the parties and the institution. Whether it extends further to issues of "creating good law" and the like is debatable.

6 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, art. V, available*, inter alia,* at http://www.uncitral .org/-pdf/english/texts/-arbitration/NY-conv/XXII_1_e.pdf.

VI. Sixth: Bias

Proponents and opponents of an appellate structure for ICSID often stray into the area of contending or denying that in the case of investor rights versus state rights, there is an inherent bias in favor of investor rights.

Query whether the ICSID (and non-ICSID) awards which have entered the public domain, particularly in the last five years, buttress the argument that there is a systemic, inherent or otherwise ineluctable bias in favor of investor protection. Surely the answer overall is largely no.

If that answer is correct, then a motivation for an appellate structure based on bias is misplaced. On the other hand, there is the perception that this is a moving target. That in the next several years more and more developing states will become defendants in ICSID and other investment arbitration. That more issues of bias may arise and that if only for perception reasons, an appellate structure applicable to all state parties alike may be politically expedient.

VII. Seventh: Challenges to Lis Pendens and Res Iudicata

The discussion surrounding an appellate structure also relates to concerns as to whether conflicts or perceived conflicts in legal holdings from one ICSID award to another relating to such issues as fair and equitable treatment, fork-in-the-road provisions, contract claims versus treaty claims, etc. are a threat to principles of *lis pendens* or *res judicata* known principally from the civil litigation field, and increasingly from international commercial arbitration.

This concern is in turn related to the notion that "forum shopping" or "treaty shopping" in the ICSID context may do violence to established notions of prior claims pending or precedent.[7] With the aid of an appellate structure, it is thought, disincentives to such shopping around might be created, thereby serving such other goals as predictability, consistency and accountability.

Whether this holds water is debatable, since the addition of an appellate stage to one arbitration does not clearly assist in preventing another arbitration (or litigation) with overlapping parties and issues from being commenced in parallel. Nor does an appellate structure for ICSID awards necessarily have any way of promoting precedential value of ICSID awards for non-ICSID investment arbitrations having different treaty bases.

7 *See, e.g., Kreindler*, "Arbitral Forum Shopping," in Parallel Arbitration Tribunals and Awards in International Arbitration, Dossiers 3 ICC Institute of World Business Law, 2005.

VIII. Eighth: Relative Adequacy of the Existing ICSID Annulment Mechanism

If the ICSID ad hoc annulment process is deemed to be working satisfactorily, then query why an additional appellate structure or an appellate structure in lieu of annulment would be called for.

Of course, annulment and appeal are not necessarily synonymous, and a two-tiered system would not be entirely unimaginable. On the other hand, proponents of an appellate structure largely have in mind a one-tier system in lieu of ad hoc annulment. For some such proponents, the annulment system thus far is perceived to have been unhelpful, unwieldy, heavily biased in favor of annulment, and a disguised means of obtaining two bites at the apple. Even if this were true, which defies the empirical and other experience, it is not entirely clear how an appellate structure would remedy or improve upon the annulment mechanism except insofar as it would be "staffed" on a consistent basis by a group of judges with long tenure who are meant to counteract the ad hoc, piecemeal approach to date.

Whether the ad hoc, piecemeal approach to date is in need of replacement is another matter altogether. On a certain level, the ad hoc, piecemeal annulment committee in an individual ICSID matter is arguably no more or less objectionable than the ad hoc, piecemeal judge or panel of judges in an individual ICC, UNCITRAL or other challenge proceeding before the Swiss Federal Tribunal, the Paris Court of Appeal or the US District Court for the Southern District of New York. While those state judges are civil servants with long tenure, that tenure per se does not necessarily guarantee long-term expertise in matters relevant to annulment of international arbitration awards. Admittedly, on the other hand, the concentration of competence and expertise now being aspired to in precisely these named courts does suggest a less ad hoc approach than that of the ICSID annulment committee mechanism.

Ultimately, each of the grounds addressed briefly above can be seen as providing a reasonable basis for considering an ICSID appellate structure, as also elucidated by Dr. *Tams*, but each one can also be turned on its head. In the final analysis, the most compelling obstacle to such a reform would be one of an entirely different, pragmatic nature: namely, the relative impracticality of seeking, let alone obtaining the necessary amendment to the ICSID Convention[8], in fulfillment of the stringent requirements for amendment.

For that reason alone, there may be little utility in taking a black-and-white position on the issue, although this can be found in recent other commentary.

8 Article 66(1) ICSID Convention provides: "(1) If the Administrative Council shall so decide by a majority of two-thirds of its members, the proposed amendment shall be circulated to all Contracting States for ratification, acceptance or approval. Each amendment shall enter into force 30 days after dispatch by the depositary of this Convention of a notification to Contracting States that all Contracting States have ratified, accepted or approved the amendment."

D. Dr. Tams' Mention of "Reference Proceedings"

The foregoing *tour d'horizon* of certain of the arguments for and against the implementation of an ICSID appellate structure or mechanism may serve, it is hoped, as a useful background to appreciate the interesting and creative remarks and study undertaken by Dr. *Tams*. In particular, they are meant to help in putting into perspective his discussion of "reference proceedings" in the context of this debate. Reference proceedings may be an alternative to the contemplation of an appellate structure, especially in view of the practical challenge of attempting to introduce such a structure by Convention amendment.

With the potential exception of intrepretative notes under NAFTA Article 1131, there is in fact no system of reference proceedings in ICSID or non-ICSID based investment arbitration. Article 1131(2) NAFTA[9] provides: "An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section." This is to be compared and contrasted with Article 64 ICSID Convention, which provides: "Any dispute arising *between Contracting States* concerning the interpretation or application of this Convention which is not settled by negotiation shall be referred to the International Court of Justice by the application of any party to such dispute, unless the States concerned agree to another method of settlement." [emphasis added]

Is possible analogous application of Article 1131(2) NAFTA a solution to the appellate structure approach, and in view of Dr. *Tams*' remarks?

On one level, the answer may be No, there are too many conceptual and other differences between NAFTA and ICSID. These include differences inherent in the simple fact that NAFTA is an MIT while ICSID is a Convention respecting dispute resolution relating to disparate BITS, MITS and also non-treaty disputes. Furthermore, there is a narrow tripartite focus of NAFTA versus the expansive, multilateral nature of ICSID.

On another level, and particularly in view of Dr. *Tams*' paper, the answer might well be Yes:

First, the Article 1131(2) NAFTA concept may be seen as existing in all cases as a matter of general treaty law. Thus Article 31(3) of the Vienna Convention on the Law of Treaties[10] provides: "[When interpreting a treaty], [t]here shall be taken into account […]: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions." The referral mechanism in NAFTA may be seen as having become a matter of general treaty law at least between and among the member states to the treaty. An analogous situation might

9 Available, *inter alia*, at http://www.investmentclaims.com/instruments/NAFTA%20Text%20%20-Excerpts.pdf.

10 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Vienna%20Convention%20on%20-the%20Law%20of%20Treaties.pdf.

be conceivable under ICSID, although again the requirement of an amendment may be unavoidable.

Second, Article 1131(2) NAFTA, at least in the narrow NAFTA context, has proven to be an effective, clear, time-efficient method for facilitating or even imposing clarity and uniformity, at least prospectively. The obvious example here is the NAFTA Free Trade Commission binding interpretation in 2001 respecting "fair and equitable treatment" under Article 1105 NAFTA as "not requir[ing] treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." There can be little doubt that – harking back to the discussion above of predictability, consistency, coherence and the like – this interpretation promptly contributed to a certain realignment of NAFTA jurisprudence.

Thus prior to the FTC interpretation the tribunal in *Pope & Talbot v. Canada* Partial Award (2001)[11] had held that "fair and equitable treatment" was an independent, self-contained, additive treaty standard. It gave a broad interpretation of Art. 1105 and imposed no threshold limitation that the conduct at issue be "egregious," "outrageous," etc. Acceptance of the narrower FTC interpretation followed in the *Pope & Talbot v. Canada* Final Award (2002)[12].

Then, in *Methanex v. US* (2005)[13], the tribunal stated that the FTC interpretation was binding not only as a matter of NAFTA law, but also pursuant to the general law of treaties, and that Article 1105 required showing the existence of an explicit rule of customary international law as being applicable to the case in order to establish a breach of the "Minimum Standard of Treatment."

NAFTA-based awards since the FTC binding interpretation continue to grapple with F&ET, but within the confines of the interpretation: *Mondev v. US* (2002)[14], *UPS v. Canada* (2002)[15], *ADF v. US* (2003)[16], *Loewen v. US* (2003)[17], *Waste Management v. Mexico* (2004)[18], *GAMI v. Mexico* (2004)[19], *Methanex v. US* (2005)[20], and *Thunderbird v. Mexico* (2006)[21].

11 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Pope-Canada-Award-10Apr2001.pdf.

12 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Pope-Canada-Damages-31May2002.pdf.

13 Available, *inter alia*, at http://www.naftaclaims.com/Disputes/USA/Methanex/Methanex_ Final_Award.pdf.

14 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Mondev-US-Award-11Oct2002.pdf.

15 Available, *inter alia*, at http://www.investmentclaims.com/decisions/UPS-Canada-Jurisdiction-22Nov-2002.pdf.

16 Available, *inter alia*, at http://www.investmentclaims.com/decisions/ADF-US-Award-9Jan2003.pdf.

17 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Loewen-US-Award-26Jun2003.pdf.

18 Available, *inter alia,* at http://naftaclaims.com/-Disputes/Mexico/Waste/WasteFinalAwardMerits.pdf.

Third, a system of binding interpretation within ICSID might be seen as doing violence to bilateral meetings of the minds in individually negotiated BITs and FTAs, including retroactively, but in fact would be fully consistent with Article 31(3) Vienna Convention on the Law of Treaties[22]. Such system, assuming it could be achieved through the necessary modalities of approval of an amendment to the ICSID Convention, would conceivably also prospectively contribute to harmonization and unification of drafting of certain typical, potentially open provisions.

These include respecting, *e.g.,* "fair and equitable treatment" and "full protection and security" in the context of "customary international law." They also include application of the proper law under the default provision in Article 42(1) ICSID Convention and supplementation of interpretation of a BIT through international law (*e.g.,* the issue in the *Wena* annulment proceedings[23]). They further include the validity of waiver of the right of annulment under Article 52 ICSID Convention, the meaning or standard of interpretation of "legal dispute" arising directly out of an "investment" under Article 25(1) ICSID Convention (e.g., *Mihaly International*[24]), and the meaning or standard of interpretation of "nationality" and "foreign control" under Article 25(2) ICSID Convention.

Fourth, issues such as arose in *SGS v. Pakistan*[25] and *SGS v. Philippines*[26] – assuming for the sake of argument that that discordance was an undesirable development – could be retroactively addressed for future cases, and even for applications for interpretation or correction within the current ICSID Convention Article 50(1) interpretation and correction scheme (*see, e.g., Wena v. Egypt*[27]). This provision states, "If any dispute shall arise between the parties as to the meaning or scope of an award, either party may request interpretation of the award by an application in writing addressed to the Secretary-General."

Fifth, the initial phase of three to five years would be one of uncertainty, instability, but perhaps no greater than what is currently occurring. After such initial phase,

19 Available, *inter alia,* at http://www.investmentclaims.com/decisions/GAMI-Mexico-FinalAward15Nov-2004.pdf.

20 Available, *inter alia*, at http://www.naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf.

21 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Thunderbird-Mexico-Award.pdf.

22 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Vienna%20Convention%20on%20the-%20Law%20of%20Treaties.pdf.

23 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Wena-Egypt-Annulment-5Feb2002.pdf.

24 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Mihaly-SriLanka-Award-15Mar2002-.pdf.

25 Available, *inter alia*, at http://www.investmentclaims.com/decisions/SGS-Pakistan-Jurisdiction-6Aug2003-.pdf.

26 Available, *inter alia*, at http://www.investmentclaims.com/decisions/SGS-Philippines-Jurisdiction-29Jan-2004.pdf.

27 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Wena-Egypt-Annulment-5Feb2002.pdf.

greater stability as to such points would occur: witness the NAFTA F&ET situation. Inconsistencies of the *Lauder*[28] variety would still occur, and perhaps should still occur, as in general commercial arbitration and litigation, but that would not be the focus of binding interpretation. And insofar as ICSID awards have a persuasive effect on non-ICSID investment-related disputes, including NAFTA, ICSID Additional Facility, UNCITRAL Rules[29] and Energy Charter Treaty[30], the ICSID binding interpretation could have a salutary effect on the uncertainties affecting various investment arbitration regimes.

Sixth, apart from the admittedly considerable obstacle of effectuating the necessary Convention amendment, a system of binding interpretation would be no more cumbersome and problematic, and arguably far less so, than various other proposals for establishment of an ICSID appellate structure, or for expansion of the ICSID annulment mechanism.

Ultimately, the chances of obtaining unanimous approval for an amendment of the ICSID Convention to institute such a mechanism may be slim, but perhaps no less slim than the chances of doing so to institute an "appellate structure." And such appellate structure might be far riskier in the conception and implementation, and also less consistent with the original goals of finality and unappealability of the Convention's original drafters. In any event, Dr. *Tams*' analysis of certain of the related issues in this debate is a valuable and perceptive contribution to a discussion which is likely to be only in its beginning stages.

28 Available, *inter alia*, at http://www.investmentclaims.com/decisions/Lauder-Czech-FinalAward-3Sept2001.pdf,http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13 Sept2001.-pdf, http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001-Dissent.pdf, http://www.investmentclaims.com/decisions/CME-Czech-Appealof PartialAward-15May2003.pdf, http://www.investmentclaims.com/decisions/CME-Czech-FinalAward-14Mar2003.pdf, http://www.in-vestmentclaims.com/decisions/CME-Czech-FinalAward-14 Mar2003-Separate.pdf, http://www.invest-mentclaims.com/decisions/CME-Czech-AppealofFinalAward2003-15May2003.pdf.

29 Available, *inter alia*, at http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules/arb-rules.pdf.

30 Available, *inter alia*, at http://www.investmentclaims.com/instruments/Energy%20Charter%20Treaty.pdf.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Christina Pfaff[*]

A. Introduction

At the dawn of the twenty-first century foreign investment and the protection of foreign investor rights belong to the most innovated fields in international law. The International Centre for the Settlement of Investment Disputes (ICSID)[1], the specifically specialized arbitral institution for the settlement of investment disputes has shaped, with enormous success, both the development and interpretation of many legal standards and guarantees in international investment law[2]. This success is based on certain unique advantages. ICSID is attached to the World Bank, unlike any other international arbitral institution. Due to the status of the World Bank[3] most countries may be more likely to observe ICSID obligations[4], which can improve the

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1 BGBl. 1969 II, p. 1191; the convention is also available at <www.worldbank.org/icsid /basicdoc/basicdoc>; the implementation of the ICSID Convention was based on the attempt of the drafters to attain a „careful balance between the interests of investors and host states,", see further *Delaume*, ICSID Arbitration and the Courts, 77 Am. J. Int'l L., p. 784 (1983); *Smutny*, Arbitration before the International Centre fort he Settlement of Investment Disputes (2002), Business Law International B.L.I., p. 367; *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 38; *Fahmi/Shihata*, The experience of the International Centre for Settlement of Investment Disputes (1999) ICISD Review, p. 299-369.

2 The number of cases before ICSID increased considerably after the invocation of arbitration under the NAFTA (North American Free Trade Agreement); see generally *Bishop/Crawford/Reisman*, Foreign Investment Disputes (2005), p. 11; it is important to note, however, that the ICSID Convention does not contain any comprehensive rule on the protection of foreign investment, but only the procedural framework, see Art. 42 (1) ICSID Convention.

3 See generally *Fahmi/Shihata*, The dynamic evolution of international organizations: the case of the World Bank (1999), Journal of the History of International Law, p. 217-249; *Tschofen*, The World Bank in a changing world (1995), p. 52.

4 *Fahmi/Shihata*, Avoidance and settlement of disputes - the World Bank's approach and experience (1999) International Law Forum, p. 90-98; *Görs*, Internationales Investitionsrecht-Vom völkerrechtlichen Enteignungsschutz zum europäischen Binnenmarkt (2005), p. 74; in that sense also *Slaughter*, The future of international law is domestic – or the European way of law, Harvard International Law Journal (2006), p. 338.

protection of investment in return[5]. ICSID is based upon an international treaty, the ICSID Convention[6]. Any breach of any obligation under the ICSID Convention implies a violation of international law[7]. Moreover, investment liberalization has been carried out primarily by bilateral arrangements[8], such as the Bilateral Investment Treaties (BITs)[9]. These agreements are entered into by trading partners and determine a consensus on the conditions of foreign investment and investor remedies between the parties[10]. Most of these BITs refer to ICSID for dispute resolution[11].

But after forty years of ICSID the time has come to not only to take stock of the work of the tribunals under the ICSID Convention, but to take potential alternative approaches to the field of foreign investment protection into account. While activities of the ICSID Tribunal have been in the centre of academic discussion for a long

5 *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97-102.

6 *Lörcher*, ICSID Schiedsgerichtsbarkeit (2005), SchiedsVZ, p. 12; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97 (99).

7 *Lörcher*, ICSID Schiedsgerichtsbarkeit (2005), SchiedsVZ, p. 11.

8 *Stoll*, WTO-Handbuch (2002), Chapter C. I. 6., para 2; *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 38-40; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 97.

9 Direct foreign investment is protected by a network of over 2400 Bilateral Investment Treaties (BITs) involving 176 countries and additionally a vast number of provisions in plurilateral and multilateral treaties concerning investment protection or international trade. These BITs have been set into function over the past 40 years and provide a legal framework for international investment on the bilateral level. They contain relatively similar provisions and create actionable standards of conduct for governments regarding the treatment of foreign investment, though the arrangements bind only the parties involved.

10 The establishment of ICSID led to an increase of legal certainty with regard to investment disputes, see *Nathan*, Submissions to the International Centre for the Settlement of Investment Disputes in Breach of the Convention (1995) J.Int.Arb., p. 27 and *Fahmi/Shihata*, Towards a Greater Depoliticalization of Investment Disputes: The Roles of ICSID and MIGA, (1986), ICSID Review FILJ, p. 3; *Schäfer*, Enteignungsstandards im Völkerrecht, RIW (1998), p. 193.

11 See <www.worldbank/icsid/about/about.>; *ICSID Secretariat*, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper 22 October 2004, para 5; *Semler*, Schiedsverfahren im Rahmen von Investitionsschutzabkommen der Bundesrepublik Deutschland (2003), SchiedsVZ, p. 99; in addition consensus on jurisdiction of ICSID can also be determined in multilateral agreements such as the NAFTA and the Energy Charter Treaty, see *Reed/Paulsson/Blackaby*, Guide to ICSID Arbitration (2004), p. 35; *Schreuer*, The ICSID Convention: A Commentary (2001), Art. 25, para 257; *Broches*, Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965 – Explanatory Notes and Survey of its Application (1993), YCA, p. 627, 643, para 35; *ibid.*, Denying ICSID's jurisdiction (1996), Journal of International Arbitration, p. 21-30; *Hirsch*, The Arbitration Mechanism of the International Centre fort he Settlement of Investment Disputes (1993), p. 48 (51), *Lew/Kröll/Mistelis*, Comparative International Commercial Arbitration (2003), Chapter 28, para 48.

period and debated extensively[12], the protection of foreign investment by other mechanisms has been much less considered. A number of international treaties dealing with the protection of (foreign) property are based upon international law[13]. In spite of the presence of property protection in both texts of international human rights and international trade law, the role of these instruments in the context of foreign investment protection remained largely irrelevant and research on this particular issue remained scarce. In addressing this gap, the present study, with due regard to the complexity of the issues, seeks to increase the level of understanding of the role of human rights and international trade mechanisms in the area of foreign investment protection, drawing on an analysis on the specific aspects of foreign investment protection in international human rights and trade law.

The emerging code of human rights provides a set of standards that apply to every sector of human interaction. In the context of foreign property protection human rights law and institutions comply with the basic rules of aliens' law, which is based on the international law principle of diplomatic protection[14]. The concept of diplomatic protection as based on the traditional view according to which the individual constitutes only a mere part of the State is founded on the traditional *do ut des* approach[15] in general international law. Understanding the instrument in such fashion limits the role of international human rights law with respect to foreign property protection. A new generation of international human rights treaties emerged and tackled this classical approach by granting treaty rights to all individuals[16]. Thus these treaties serve the benefit of all individuals, irrespective of their citizenship, and the international legal community, as its observance is monitored by all state parties equally. Yet, the protection of foreign investment and the protection of foreign property in general international law are footing on different goals: Human rights[17] together with aliens' law aim at a certain detachment of the individual from the state as well as a civilized conduct among states while the law on foreign investment protection focuses at protecting foreign investment as such. These differences have

12 See *Schreuer*, The ICSID Convention - A Commentary (2001), Art. 25, paras 92 –125 and the references cited.

13 *E. g*. the European Convention on Human Rights, which talks about international law in general in its Art. 1 of the First Additional Protocol.

14 *Diplomatic Protection* is to be understood as the protection given by a subject of international law to individuals, *i. e.* legal or natural persons, against a violation of international law by another subject of international law, see *Geck*, Diplomatic Protection, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. I (1992), p. 1046.

15 The *do ut des* approach is also defined as the concept of reciprocity; see further *Parisi/Ghei*, The role of reciprocity in international law, Cornell International Law Journal (1968), p. 93-123. For a methodical approach see *Kahan*, The logic of reciprocity (2003) Michigan Law Review, p. 71-103.

16 *E. g*. the European Convention on Human Rights (1950), see Articles 24 and 44.

17 Human rights are defined as "those claims made by men, for themselves or on behalf of other men, supported by some theory which concentrates on the humanity of man, on man as a human being, a member of mankind.", *Dorwick*, Human Rights, Problems, Perspectives and Texts (1979), p. 8.

had a strong influence on the protection of (foreign) property by human rights instruments with regard to consistency and coherency issues in jurisprudence, and, as a consequence thereof, on the entire role of human rights institutions in the field of foreign investment.

Trade and investment are closely linked with each other[18]. Both are complementary and substitute strategies for business looking for access to foreign markets, and the realisation of new commercial opportunities[19]. As establishing a commercial presence in a foreign country is one of the modes of delivering services investment goes often hand in hand with trade in services as well. From an economic perspective, foreign investment is a core part of the linkage between global markets and international trade[20], because access to the markets through a commercial presence brings about foreign investment, which may lead to additional trade[21]. Both concepts appear as two sides of the same coin. This substantial overlap between trade and investment law leads to the World Trade Organisation (WTO) and their role in the context of foreign investment. Some WTO Agreements contain investment provisions, e.g. the *Agreement on Trade-related Investment Measures* (TRIMs) and the *General Agreement on Trade in Services* (GATS), but more or less as incidental matters to some main theme. In addition, the panels set up under the *Dispute Settlement Understanding* (DSU) had to deal with investment issues occasionally[22]. Yet, the close linkage between trade and investment sharply contrasts with the current role of the WTO in the field of foreign investment protection, in particular since investment appears as the "missing panel" in the system and no comprehensive multilateral agreement on foreign investment protection under WTO auspices could be successfully concluded[23].

18 See *e.g.*, *WTO*, Working Group on the Relationship between Trade and Investment, The Relationship Between Trade and Foreign Direct Investment, WT/WGTI/W/7, 18 September 1997.

19 *Sauve*, Advisor of the OECD's Trade Directorate (2003) emphasized this assumption by stating that „the absence of a creditable and coherent regime for international investment is particularly glaring at a time when investment (more than trade) has become the driving force of deepening integration in the world economy", Trade Rules behind Borders, Essays on Service, Investment and the New Trade Agenda (2004), p. 22 f.

20 *Lörcher*, ICSID-Schiedsgerichtsbarke*it* (2005), SchiedsVZ, p. 11; *Tietje*, Die Beilegung internationaler Investitionsstreitigkeiten, in Streitbeilegung in den internationalen Wirtschaftsbeziehungen, (*Marauhn,* ed.) p. 49.

21 See *Jessup*, A Modern Law of Nations (1968) 10, stating that "The function of the law of responsibility of States for injuries to aliens … is to provide in the general world interest, adequate protection for the stranger, to the end that travel, trade, and intercourse may be facilitated".

22 Panel Report, *Indonesia - Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R; WT/DS59/R; *Canada- Administration of the Foreign Investment Review Act* (FIRA), BISD 30S/140 (1984).

23 In this context, *Sauve* (supra note 19, p. 24) stated that the "patchwork quilt of different bilateral treaties, regional arrangements, and limited pluri-lateral or multilateral instruments relating to investment stands in sharp contrast to the comprehensive system of norms and principles governing international trade."

The task of this paper consists in illuminating the current state of foreign investment protection by other mechanisms than the ICSID focusing on human rights institutions and the WTO. It attempts to provide a survey on relevant human rights institutions and provisions of the WTO agreements dealing with foreign investment issues. The conceptual approaches to the issue of foreign investment protection in international human rights law and in international trade law are analyzed in order to draw conclusions on the advantages and disadvantages of each system from the investor's perspective. In addition, a critical look is taken at relevant court decisions rendered in the context of foreign investment protection. The paper does not, however, aim at comparing these mechanisms and their systems but instead points at the respective advantages and disadvantages of each mechanism, in particular as against ICSID. These considerations permit an evaluation of the elements which define the role of the human rights systems and the WTO system with respect to foreign investment protection.

The paper is structured as follows. As a starting point, Chapter B gives a brief overview of the historical development of foreign property protection in general international law. It focuses on the rule of diplomatic protection which as a concept has experienced an on-going adjustment to the development of general international law over the last decades. The traditional approach of diplomatic protection[24] appears to have somewhat changed, as rights and entitlements are accrued to the individual by human rights conventions. The conceptual understanding of the instrument has been defined and clarified by the jurisprudence of the *Permanent Court of International Justice* (PCIJ) and the *International Court of Justice* (ICJ). Various court decisions, such as the *Barcelona Traction* Case, tackled the concept of the rule of diplomatic protection. The analysis of the decisions shows the continuing adjustment of the rule of diplomatic protection in general international law.

Chapter C provides an overview of the universal and regional human rights institutions playing a role in the field of foreign investment protection. In this context, the paper focuses on the category of treaties which accord treaty rights to all individuals and thus create a favourable legal position for foreign investors. The respective treaties as well as the pertinent jurisprudence are introduced and analyzed by identifying their specific features which render one instrument more or less suitable for foreign investment protection than another. Chapter C illustrates the principal characteristics of foreign property and investment protection in international human rights law and argues that international investment law and human rights are based on different grounds.

Next, Chapter D points at clarifying the role of the WTO in the field of foreign investment. This topic is approached by a short survey on the development of foreign investment protection within the WTO system. The core part of the Chapter focuses on the WTO agreements dealing with investment issues. The provisions of

24 The traditional approach of *diplomatic protection* determined the mediatisation of the individual entirely.

the agreements are examined with regard to the respective jurisprudence. The paper argues that despite the close linkage between trade and investment the current approach of the WTO to the field of foreign investment is dominated by the attempt not to include comprehensive investment provisions into the existing agreements due to conflicts attached to the issue. This assumption creates obstacles for a potential multilateral comprehensive agreement on foreign investment. These obstacles are illustrated and summarized in Part III which aims at defining overlaps and divergences between trade law and investment law as well as the need for a multilateral regime, in particular with regard to consistency and coherence in international jurisprudence. The paper concludes with part E, which evaluates the results of the analytical framework and assesses potential as alternative approaches to foreign investment protection as compared to the ICSID Convention.

B. The Protection of Foreign Property in General International Law

Fundamental to the protection of foreign investment is the concept of property. The protection of (foreign) property[25] by rules of international law has been subject to on-going controversial debates[26] and the question of property rights of aliens has become rather separated from that of a general minimum standard of protection. The traditional protection of foreign investment was based on the rules of aliens' law[27], in particular the international expropriation rules[28], as aliens may have claims against natural or legal persons and institutions in a foreign state[29]. Pursuant to the rules of international law only the home state of the foreign investor can assert

25 Alien property is determined by the effective power to enforce measures against such property, see *Seidl-Hohenveldern*, Aliens, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. I (1992), p. 116.

26 *Dolzer*, New Foundations of the Law of Expropriation of Alien Property , American Journal of International Law (1981), p. 553- 589; *Verwey*, The Taking of Foreign Property under International Law: A New Legal Perspective?, Netherlands Yearbook of International Law (1984), p. 3-96; *Borchardt*, The Diplomatic Protection of citizens abroad (1915), p. 8-56; *Slaughter/Tulumello/Wood*, International Law and International Relations Theory: A new Generation of Interdisciplinary Scholarship, American Journal of International Law 92 (1998) p. 367-397; *von Glahn*, Law among Nations; An Introduction to Public International Law (1996); *Frieden*, Invested Interests: The Politics of National Economic Policies in a World of global Finance, International Organizations 45 (1991) p. 425-451; *Seidl-Hohenveldern* (supra note 25) at 116 with further references.

27 *Ipsen*, Individualschutz im Völkerrecht, Zum völkergewohnheitsrechtlichen Mindeststandard, in Völkerrecht (*Ipsen,* ed.), § 50, para 2.

28 *Banz*, Völkerrechtlicher Eigentumsschutz durch Investitionschutzabkommen, insbesondere die Praxis der Bundesrepublik Deutschland seit 1959 *(*1988*)*, p. 135; *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 3.

29 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 135.

claims on the basis of diplomatic protection[30] in case of interferences with aliens' property. The rule of diplomatic protection reflects the traditional view in international law "that a State is in reality asserting its own rights- its right to ensure, in the person of its subjects, respect for the rule of international law."[31] Thus the link of nationality gives the state the right to protect its nationals against abuses by other states. The concept rests on the assumption that not individuals, but their home states are the holders of the rights granted in international law, as the individual is a mere part of its home state[32]. In addition the home state of the investor will not accept the exclusive power of the host state to judge on the legality of the taking and the amount of compensation due[33]. The exhaustion of local remedies is an obligatory prerequisite for the application of the rule of diplomatic protection[34].

The scope of the international law norms concerning protection of (foreign) property comprises not only the "classical" expropriation cases but also cases where measures tolerated or adopted by the host state impair and defeat the effective use of alien property as if it were deprivation of it[35]. International law does not exclude interference with alien property entirely, but interference with it may violate international discrimination rules, if such measures are directed exclusively against fo-

30 *Diplomatic Protection* is to be understood here as the protection given by a subject of international law to individuals, i. e. natural or legal persons, against a violation of international law by another subject of international law. The legal institution of *diplomatic protection* has been shaped by some important developments in the international legal community, e. g. by the evolution of human rights and by efforts to raise individuals more and more to the status of subjects of international law.

31 *Mavrommatis Palestine Concessions*, PCIJ, Series A, No. (1924); PCIJ, Series No. 5 (1925), judgment p. 6 at p. 12; c. f.; also *Barcelona Traction, Light and Power Company*, Judgment ICJ reports (1970), 45; separate opinion of Judge *Morelli*, at p. 222 (226).

32 This viewpoint is backed by the concept of reciprocity (traditional *do ut des* between states).

33 United States –Iran Agreement on 19 January 1981 (Hostages and Financial Arrangements); see *Aldrich*, What Constitutes a Compensable Taking of Property? The Decisions of the United States-Iran Claims Tribunal, 88 American Journal of International Law, (1994), p. 585 (610); *Baker/Davis*, Arbitral Proceedings under the UNCITRAL Rules - The Experience of the United States-Iran Claims Tribunal, 23 George Washington Journal of International Law & Economics (1989), p. 267 (347); *Briner*, Luncheon Talk: The United States-Iran Claims Tribunal and Disputes Involving Sovereigns, 18 Arbitration International 299 (2002); *Jones*, The United States-Iran Claims Tribunal: Private Rights and State Responsibility, 24 Virginia Journal of International Law (1984), p. 259 (285); *Lillich*, The United States-Iran Claims Tribunal, 1981-1983 (1985), p. 15 f.

34 The requirement that individuals first exhaust local remedies gives states – and particularly their domestic courts – an incentive to reach conclusions acceptable to the international institution so that the international court need not intervene to review the case; see e. g. the *Mavrommatis Concession* Case, PCIJ, Series A, No. 2 (1939), p. 6 at p. 12 of the 1924 judgment; *Panevezys-Saldutiskis Railway* Case, PCIJ, Series A/B, No. 76 (1939), p. 4 at p. 18*;* Electricity Company of Sofia Case, PCIJ, Series A/B, No. 77 (1939), p. 64 at p. 78 and *Interhandel* Case, ICJ Reports 1959, p. 6 at p. 27.

35 These measures are referred to as a „*creeping nationalization*" or a so-called „*constructive taking*".

reigners[36]. The host state has to grant minimum standard compensation[37] due for the taking of the property to citizens and aliens alike[38].

Recently, the International Law Commission (ILC), a permanent organ for the codification of international law[39] decided, subject to the approval of the General Assembly[40], at its forty-seventh session (1995) to include the issue of diplomatic protection on its agenda[41] and qualified the topic as appropriate for codification and progressive development in international law. At the fifty-eighth session (2006) the ILC adopted a text of draft articles concerning the rule of diplomatic protection and, thus, concluded its work on this issue[42]. The current draft version of the articles on diplomatic protection contains a chapter on general principles of diplomatic protection, such as a definition of term and scope[43]. The following chapters address *inter alia* the local remedies rule and the status of legal and natural persons[44]. The draft articles, however, deal only with the secondary rules[45], which are the rules relating to the conditions that must be met for bringing a claim for diplomatic protection. In

36 This problem was addressed in the *Chilean Copper Nationalization* Case by the Landgericht Hamburg, Chile-Kupfer Streit, Court Decision of 22 January 1973, Außenwirtschaftsdienst des Betriebsberaters (AWD), Vol. 19 (1973) p. 163-165 and Court Decision of 13 March 1974, AWD, Vol. 20, p. 410-413; English version available in ILM, vol. 12 (1973) p. 251-289 and ILM, Vol. 13 (1974), p.1115-1120; and the Tribunal de Grande Instance de Paris, Corporación de Cobre c. Societé Brade Copper Corporation et Societé du Groupement d'Importation des Metaux, 29 novembre 1972, clunet, vol. 100 (1973) p. 227-238, English version available in ILM, Vol. 12 (1973), p. 182-189; *Behrens*, Rechtsfragen im chilenischen Kupferstreit, Rabels Zeitschrift für ausländisches und internationales Privatrecht (1973), p. 394 (435); *Seidl-Hohenveldern*, Chilean Chopper Nationalization Cases before German Courts, American Journal of International Law , vol. 69, No. 1, (1975), p. 110-119.

37 The minimum standard is defined as *prompt, adequate and effective* compensation.

38 *Garcia-Amador*, Fourth Report on International Responsibility, YILC (1959 II) 1-36; *ibid.,* State Responsibility: Some new Problems*;* Recueil des Cours, vol. 94 (1958-II) , p. 365 (491); *Parry/Clive*, Some considerations upon the protection of individuals in international law*;* Recueil des Cours, vol. 90 (1956-II), p. 653 (726).

39 For a general survey see *Sir Vallat*; International Law Commission, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. II (1995) p. 1208-1212.

40 The General Assembly instructed the ILC in 1996 to further examine the topic and to define its scope and content in the light of the observations made during debates, Resolution 51/160 of 16 December 1996; see also A/51/358 and Add. 1. Pursuant to General Assembly resolution 51/160, the ILC established a Working Group on the topic at its forty-nine session (1997). The report of the Working Group was endorsed by the ILC, Yearbook ILC, vol. II, para 171.

41 See Yearbook ILC (1995), vol. II, para 501. Pursuant to General Assembly resolution 51/160 of 11 December 1996, the ILC included this topic on its agenda at its forty-ninth session (1997), Official Records of the General Assembly, Fifty-second Session, Supplement No. 10 (A/52/10), paras 169-171.

42 Report of the International Law Commission, Fifty-eighth Session (2006), Chapter IV, p. 16.

43 See Chapter I, Article 1 and 2; yet, the draft article makes no attempt to provide a complete and comprehensive definition of diplomatic protection. It rather defines the salient features of the rule in the sense in which the term is used in the present draft articles.

44 See Chapter II, Article 4 and Chapter III, Article 9.

45 The primary rules, which govern the treatment of the person and property of aliens, see Report of the International Law Commission, Fifty-eighth Session (2006), Chapter IV, p 22 (23).

addition, certain weaknesses inherent to the instrument, such as the protection of stateless persons[46] or the exhaustion of local remedies[47] as a prerequisite for the application of the rules of diplomatic protection were tackled by the draft codification. It is important to note that any rights resulting from either customary international law or bilateral or multilateral human rights treaties remain unaffected[48]. Ultimately, draft Article 17 deals with foreign investment, stating that "[t]he present draft articles do not apply to the extent that they are inconsistent with special rules of international law, such as treaty provisions for the protection of investment." The article contributes to treaties, which, within their provisions concerning dispute resolution, exclude or depart substantially from the rules governing diplomatic protection. BITs or the multilateral ICSID Convention are the primary examples of such treaties[49]. Their provisions for dispute resolution allow direct access of the investor to international arbitration and dispense with the conditions for the exercise of diplomatic protection. Avoiding political uncertainty as an inherent factor in the nature of diplomatic protection is another advantage for dispute resolution in accordance with these respective treaty provisions. The ILC draft articles are notably based on the jurisprudence rendered by international tribunals with regard to the instrument of diplomatic protection.

46 Article 8 of the draft version.

47 Article 14 of the draft version; Article 15 determines recognized exceptions from the local remedies rule.

48 A state may protect an individual in inter-state proceedings under the International Covenant on Civil and Political Rights (United Nations, Treaty Series, vol. 999, p. 171), the International Convention on the Elimination of All Forms of Racial Discrimination (article 11), the Convention on Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (United Nations, Treaty Series, vol. 1465, p. 85, art. 21), the European Convention on Human Rights (article 24), the American Convention on Human Rights (art. 45) and the African Charter on Human and People's Rights (United Nations, Treaty Series, vol. 1520, p. 217, arts. 47-54), see draft article 16.

49 Article 27 (1) of the ICSID Convention reads: „No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.", see United Nations, Report of the International Law Commission, Fifty-eighth Session (2006), p. 89 (90).

I. Historical Development of Investment Protection in International Law

During the eighteenth and nineteenth centuries foreign investment was largely made in the context of colonial ambitions[50]. Notions of collective ownership of property which were widely prevalent in the colonies were replaced by European notions of individual property[51]. The common form of foreign investment of these days was indirect, through loans and government bonds, and foreign direct investment, on which this paper is focused, started to take shape only in the late nineteenth century. The increase of such foreign direct investment was promoted by two independent, but interrelated developments, which were, on the one hand, the rapidly increasing rate of technological invention and, on the other hand, the growth of corporations. When the host governments expropriated property of investors from another state, the government of the investor would provide *diplomatic protection*[52], which is defined as the exclusive right of the state to pursue treaty rights beneficial to its nationals in the international context[53]. The claims based on the rule of diplomatic protection were commonly dealt with by ad hoc tribunals or mixed claims commissions to adjudicate the claims. The instrument of diplomatic protection allowing for the intervention of the government of the investor led to conflicts with the host government. This development culminated in the formulation of the "*Calvo-Doctrine*"[54], which embodied the Latin American version of the principle of equality between nationals and aliens due to the abusive exercise of the right of diplomatic protection[55]. The doctrine promulgated that foreign investors were entitled to treat-

50 During the nineteenth century, optional treaty standards hardened into rules of international customary law or became considered as general principles of law recognised by civilised nations. These standards require the compliance of the rule of law (in the meaning of the continental *Rechtsstaat*), the right to full, prompt and effective compensation and the exhaustion of local remedies.

51 This protection was to ensure that colonial legal systems were changed in order to accommodate European notions of individual rights of property and freedom of contract.

52 See *Lillich*, The Diplomatic Protection of Nationals Abroad: An Elementary Principle of International Law Under Attack, American Journal of International Law, vol. 69, No. 2 (1975), p. 359-365; *Gramlich*, Diplomatic Protection Against Acts of Intergovernmental Organs, German Yearbook of International Law, vol. 27, (1984), p. 386 (428).

53 At that time diplomatic protection was usually pursued through exchanges of diplomatic notes between the governments or espousing a formal claim on behalf of the investor as a state national on a government to government basis.

54 The name of the doctrine refers to the Argentinean diplomat and jurist *Carlos Calvo*, who shaped the „*Calvo*-Doctrine" in 1868. The doctrine states that "aliens who established themselves in a country are certainly entitled to the same rights of protection as nationals, but they cannot claim any greater measure of protection."

55 Some American States suspected *diplomatic protection* to be a potential instrument for stronger states in order to achieve economic intervention, intrusion into their domestic jurisdiction, imperialism and neo-colonialism.

ment no different or better than citizens of the host state[56]. According to the doctrine, foreign investors were to have their claims heard by the courts of the countries where they invested, but they were not entitled to seek the diplomatic protection of their governments or to have claims presented to international tribunals. The doctrine has been embodied in some international instruments: on the Seventh International Conference of the American States[57] the *Calvo-Doctrine* was explicitly incorporated into the Convention on Rights and Duties of States[58]. Nevertheless the *Calvo-Doctrine* proved to be no obstacle to legal actions based on violations of established international obligations referring to the treatment of aliens, as the international responsibility was drawn into question[59].

In the beginning of the twentieth century, foreign investment disputes were widely brought about by land reform measures in certain countries, such as the transformation of the entire Czarist economy in the Soviet Union to socialism in 1917 and the disruptions of World War I. Prior to 1917 a common understanding, the *traditional consensus* among the principal nations existed which embodied the obligatory rule of prompt and adequate compensation in case of a state taking an alien's property[60]. In addition, states adhered to the rule of diplomatic protection in its traditional sense. This situation changed in connection with the Russian Revolution[61] and World War I and led to the denial of private property in the Soviet Union

56 *Calvo* assumed that the acknowledgment of the minimum international standard would lead to „an exorbitant and fatal privilege, essentially favourable to the powerful States and injurious to the weaker nations, establishing an unjustifiable inequality between nationals and foreigners, *Garcia-Amador*, Calvo Doctrine, Calvo Clause, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 521, 522; *Shea*, The Calvo Clause, A Problem of Inter-American and International Law and Diplomacy; Modern Law Review, vol. 20, No. 4, (1957), p. 428-429.

57 The First International Conference of American States was held in Washington in 1889/1890 and the Seventh Conference in Montevideo in 1933. The formulation was officially adopted in the following words: "1. Foreigners are entitled to enjoy all the civil rights enjoyed by natives; and they shall be afforded all the benefits of said rights in all that is essential as well as in the form or procedure, and the legal remedies incident thereto, absolutely in like manners as said natives; 2. A nation has not, nor recognizes in favour of foreigners, any other obligations or responsibilities than those which in favour of the natives are established, in like cases, by the constitution and the laws.", see also *Scott*, The International Conferences of American States, 1889 to 1928 (1931), p. 45.

58 The Convention states that „Nationals and foreigners are under the same protection of the law and the national authorities and the foreigners may not claim rights other more extensive than those of the nationals" (Art. 9); the doctrine was also taken up in another inter-American instrument, the 1902 Convention Relative to the Rights of Aliens (Art. 2).

59 *Shea*, The Calvo Clause, A Problem of Inter-American and International Law and Diplomacy, Modern Law Review, vol. 20, No. 4, (1957), p. 428-429.

60 See Art. 46 II Fourth Hague Convention of 1907, which states that „private property cannot be confiscated".

61 See *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 18 and references cited there in footnote 24.

between 1917 and 1962[62]. The end of World War I witnessed the establishment of the Permanent Court of International Justice (PCIJ)[63]. This court rendered two leading decisions referring to the matter of diplomatic protection and the protection of alien's property in the 1920s: the *Oscar Chinn* Case and the *Mavrommatis Concessions* Case.

The end of World War II was accompanied by the imposition of socialist economies in Eastern Europe, the nationalization of certain industries in Western Europe[64] and the independence of former colonial territories. These developments caused an increasing number of foreign investment disputes which needed to be resolved. Thus the rules of international customary law were reaffirmed[65]. In this period of time property rights including the right to compensation for expropriation have been included in the Universal Declaration of Human Rights (1948), the European Convention on Human Rights (1950), the American Convention on Human Rights (1969) and the African Charter on Human and People's Rights (1981)[66]. These instruments grant, irrespective of the principle of reciprocity (*do ut des*), the treaty rights to everyone regardless of e. g. nationality, which brought about a legal emancipation of the individual and led to a somewhat different understanding of the concept of diplomatic protection. The Cold War period brought further conflicts[67], as a section of the world proclaimed its adherence to the "*Hull-Rule*"[68], while other large

62 See *Degras*, Soviet Documents on Foreign Policy, vol. I (1951), p. 98 (Decree of the Council of People's commissars on the General and Legal Conditions for Concessions, 23 November 1920); Mexico followed Russia by changing its constitution in the sense that no protection of property whatsoever was guaranteed.

63 The Permanent Court of International Justice did its best to stigmatise the measures of liquidation of enemy property under the Peace Treaties of 1919 as exceptions from the traditional rules of international law as well as to reaffirm the minimum standard of international law on the protection of foreign property. The court made it clear beyond doubt that once a breach of international standards occurred, it was irrelevant if the state concerned applied the same treatment to its own nationals. Non-discrimination was not to be regarded as a justification for a violation of the minimum standard of international law, see *Roth,* The Minimum Standard of International Law applied to Aliens (1949), p. 81.

64 France and the United Kingdom.

65 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 187.

66 In addition, these rights have been included in the constitutions of many countries and private initiatives to address the treatment of foreign investors were set off: the International Chamber of Commerce (ICC) adopted the International Code of Fair Treatment of Foreign Investors in 1949.

67 See *inter alia* the United States Supreme Court, stating in 1962: "There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens", *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, at p. 428 (1964). The "social function of property" and the "redistribution of wealth" competed with the traditional Western concepts of private property and protection of aliens.

68 The *Hull*-Rule is named after the American Secretary of Foreign Affairs, *Cordell Hull*, calling for prompt, adequate and effective compensation, see 32 Am.J. Int'l L., Supp., p. 181-207 (1938). The Hull-Rule proclaimed adequate and partial rather than full compensation and was therefore met by heavy criticism, see further *Schwarzenberger*, Foreign Investments and International Law (1969), p. 7 (8).

sections of it regarded this rule and its equivalents as tailor-made for imperialist powers. Many socialist countries banned foreign direct investment in their territories altogether. Treaties of Friendship, Commerce and Navigation (FCN) were negotiated by a few countries in the upcoming period to regulate the treatment of foreign investment. Furthermore the International Court of Justice was newly formed[69]. In 1962 the UN General Assembly adopted Resolution 1803[70] to express the traditional consensus[71] determining specific conditions in case of expropriation or nationalization of property[72].

After the pronouncement of Resolution 1803 the World Bank drafted a Convention, which was supposed to set up a proper institutional framework for the settlement of investment disputes[73]. The result of these endeavours is the ICSID-Convention[74], which came into force in October 1966 only eighteen months after its drafting[75]. The Convention created the International Centre for the Settlement of Investment Disputes to administer arbitrations between contracting governments and investors of other states. The Convention does not provide a specific rule of international law on a comprehensive basis for the future development of the protection of international investment, but institutional rules and administrative and financial

69 In 1952 the ICJ found it lacked jurisdiction on an investment dispute between the British government and Iran in the case *Anglo-Iranian Oil Co*. (United Kingdom v. Iran), Judgment of 22 July 1952.

70 UN General Assembly Resolution 1803 (XVII), 14 December 1962, Permanent Sovereignty over Natural Resources.

71 The traditional consensus determined that "nationalization, expropriation or requisitioning have to be based on grounds or reasons of public utility, security or the national interest. These have to be recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law…", General Assembly resolution 1803 (XVII), 14 December 1962, Permanent Sovereignty over Natural Resources. The Charter of Economic Rights and Duties of States (UN G. A. Resolution 3281 (XXIX) of December 12, 1974) stipulates that each State has the right „ to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless [otherwise agreed]" (Art. 2 (2) (c)).

72 The resolution was met by heavy criticism, as it determined a trend towards further vagueness, which was illustrated by terms such as „appropriate compensation" (adopted in Res. 1803) or the formula of „reasonable, adequate and reasonable prompt" compensation, see further *Friedmann*, A.S.I.L. Proceedings (1963), p. 127 (128); *ibid.*, Restatement of the Law, Second – Foreign Relations Law of the United States (1965), p. 563; *Metzger*, Law of International Trade, vol. I (1966), p. 112 *et seq*.

73 So far it can be stated that the ICSID Convention is still representing the consensus reached in Resolution 1803.

74 See BGBL. 1969 II 369.

75 *Schreuer*, The ICSID Convention: A Commentary (2001), p. 4, mn. 10.

regulations for the settlement of disputes[76]. In the 1970s the consensus found in Resolution 1803 and the standards for treatment of foreign investment as well as the content of the international law that governs it began to be drawn into question by a growing number of developing states regarding the issue of economic decolonization[77]. As a result thereof, many industries were nationalized by Third World governments[78]. In 1974 the United Nations General Assembly adopted Resolutions 3201 (S-VI) and 3281 (XXIX) in order to establish a so-called "New International Economic Order". The Charter of Economic Rights and Duties of States accorded to reach state the right "to nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless [otherwise agreed]."[79]

Both resolutions were backed by a majority of the developing states, as they asserted each country's right to a free choice of its economic system as well as the right to exercise sovereignty over its natural resources. But the assumptions of the 1960s and 1970s regarding the tension between foreign investment and economic decolonization revealed to be erroneous[80]: In the 1980s it became evident that coun-

76 Pursuant to Article 42 of ICSID Convention "the responsible arbitration courts have to settle the dispute on the grounds of the law of the state involved" and to apply "such rules of international law as may be applicable".

77 This relates to the issue of „permanent sovereignty of natural resources", the matter of the "New Economic Order" and the Charter of Economic Rights and Duties of States of 1974 (UNYB 1974, 402); see *Dolzer*, Wirtschaft und Kultur im Völkerrecht, in Völkerrecht, (*Vitzthum,* ed.), 6. Abschnitt I 3 e, para 30, 31 and 6. Abschnitt I 3 a , para 44-47; *Gloria*, Völkerrechtlicher Eigentumsschutz, in Völkerrecht (*Ipsen* ed.), § 47, para 1; United Nations, Department of Economic and Social Affairs, The External Financing of Economic Development (1968 – E.68.II D.10), Section 84, p.31; *Schwarzenberger*, Foreign Investment and International Law (1969), p. 7; *Dolzer*, Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht (1985), p. 24 (25).

78 Implementing such policies the Libyan government under the leadership of *Mu'ammar Qaddafi* nationalized in 1971 the petroleum industry, Kuwait in 1980 the petroleum interests of the American Independent Oil Company and Chile from 1955 to 1973 the copper mining companies, see generally *Sornarajah*, The Clash of Gobalisation and the International Law on Foreign Investment, at a Symposium at the Norman Paterson School of International Affairs on 12 September 2002, p. 4.

79 Art. 2 (2) (c) UN-Res. 3281; legal sovereignty in international law determines that a sovereign state may exercise its sovereignty only subject to compliance with all other rules of international law, see *Larson*, Sovereignty within the Law (1965), p. 332.

80 The world total investment abroad at the end of 1966 was estimated at $ 90 billion. Accumulated foreign direct investment by capital exporters in less developed countries were estimated to have amounted to $ 30 billion at the end of 1966. Between 1964 and 1966, the annual private capital export from members of the Development Assistance Committee (D.A.C.) of the Organisation for Economic Co-operation and Development (OECD) to developing countries averaged $ 3, 5 billion, of which $ 2 billion were private investment, OECD Background Paper on Private Investment in Less Developed Countries, 6 May 1968 (Press/A (68) 23, p. 2).

tries acting hostile to foreign investment were being left behind in the race for economic growth and aliens' property was considered as an asset of the host state.[81] The law on foreign investment has witnessed an explosive growth ever since[82]. In the 1990s the fall of socialism and the dissolution of the Soviet Union gave a significant impetus for an improvement of the climate for foreign investment. A remarkable consensus[83] could be generated concerning the standards for treatment of foreign investment. The USA drafted a Model BIT, which served as a role model for many BITs coming into effect and concluded a regional Free Trade Agreement, the North American Free Trade Agreement (NAFTA) in the 1990s[84]. These BITs were followed by the Energy Charter Treaty in 1994 which is dealing with investment issues in the energy sector, and the idea to bring about an international foreign investment regime accelerated. In 1996 the WTO implemented a "Working Group on Foreign Investment" with the task to negotiate such multilateral agreement which, however, failed to achieve this goal[85]. The dynamic development of foreign investment law found its most ambitious initiative in the unsuccessful effort taken by the OECD to

81 Developing countries are becoming more important as host countries for foreign direct investment (FDI) activities. Their share of global FDI flows increased from 21 % in 1991 to 36 % in 1997. Despite the crisis in financial markets in Asia at the end of the twentieth century, FDI flows into developing countries in Asia remain strong and reached the mark of $ 78 billion, UNCTAD, Investment Report (1999). Today the 48 less-developed countries (LDCs) remain marginal recipients of FDI receiving only 2% of all FDI to developing countries and 0.5% of the global total. But among the top ten in terms of absolute increases, eight were developing countries, led by Mexico, China and South Africa. Conversely, among the ten countries experiencing the steepest declines in FDI in flows, eight were developed countries (Belgium, Luxembourg, the United States and Germany reported the largest declines).

82 From 1980 until today the world-wide investment flows increased enormously: compared with the world-wide trade increase the annual percentage has increased about six fold. These numbers fluctuate depending on the state of the world-wide economy, see <http://www.unctad.org/en/docs/wir2005overview_en.pdf>. The global FDI Stock is a measure of the investment underlying international production. In 1996, the global FDI stock valued $ 3.2 trillion. Its rate of growth over the past decade was more than twice that of fixed capital formation, indicating an increasing internationalization of production systems, see *UNCTAD*, Investment Report (1998); in 2001 the book value of the FDI valued approximately $ 6, 8 trillion, International Monetary Fund Statistics Department, Foreign Investment Trends and Statistics (2003).

83 The consensus was named the "*Washington Consensus*". The term referred to the alliance between the US Government, the International Monetary Fund and the World Bank, which are all located in Washington D. C.

84 *Sornarajah*, The Clash of Globalisations and the international law on foreign investment, The Simon Reisman Lecture in International Trade Policy, Symposium at the Norman Paterson School of International Affairs on 12 September 2002, p. 3.

85 *Graham*, A note why multilateral negotiations failed at the OECD, and how such negotiations might be crafted to succeed at the WTO, Private Investments abroad – Problems and Solutions in international Business (1999), p. 3-9; for a comparative study see *Kurtz*, A general investment agreement in the WTO – Lessons from Chapter 11 of the NAFTA and the OECD Multilateral Agreement on Investment, Jean Monnet Working Paper (2002), p. 73.

draft a comprehensive Multilateral Agreement on Investment (MAI)[86]. The favourable climate for foreign investment was damped by a succession of economic crises, in particular in Asia at the beginning of the twenty-first century and set the initial stage for a new evaluation of foreign investment law.

II. Leading Court Decisions

Not only scholars were involved in the process of the conceptual evolution of property protection in international law and the interpretation of pertinent treaty law, which shaped the development of alien property and investment protection, but also certain courts and arbitral tribunals: In particular, the *Permanent Court of International Justice* (PCIJ) and the *International Court of Justice* (ICJ) had to deal with cases raising issues of alien property and investment protection.

1. The Permanent Court of International Justice

The Permanent Court of International Justice was the precedessor of the International Court of Justice[87]. The idea of furthering the peaceful settlement of international disputes was first raised in 1899 and 1907 at The Hague Peace Conference. The Convention on the Pacific Settlement of International Disputes was adopted, which dealt not only with arbitration but also with other methods of peaceful settlement such as good offices and mediation. The convention made provisions for the creation of permanent machinery for dispute resolution[88] and in 1902 the Permanent Court of Arbitration started operating[89]. At the Second Conference proposals were made to establish a Permanent International Court which resulted in a draft for the

86 The MAI resulted in the abandonment of the initiative because of anti-globalisation protests aiming at the implementation of restrictions for multinational corporations. As consequence, many countries withdrew from the initiative; see generally *Muchlinski*, Towards a multilateral agreement on investment (MAI), the OECD and WTO models and sustainable development, in International economic law with a human face (*Weiss* ed.), (1998) p. 429-451; *Karl*, Das Multilaterale Investitionsschutzabkommen (MAI), RIW, (1998), p. 432 (440); *ibid.*, On the way to multilateral investment rules- some recent policy issues (2002), ICSID Review, p. 293-319; *ibid*., Internationaler Investitionsschutz - Quo vadis? (2000), Zeitschrift für vergleichende Rechtswissenschaft, p. 143 (169); *Brewer*, Investment Issues at the WTO: the Architecture of Rules and the Settlement of Disputes, Journal of International Economic Law, vol. 1, No. 3 (1998), pp. 457.

87 See <http://www.icj-cij.org/icjwww/ibluebook.pdf>.

88 The said machinery was to enable arbitral tribunals to be set up as desired and to facilitate their work.

89 The convention further created a Permanent Bureau, which was and still is located at The Hague. The Bureau assumed functions corresponding to those of a court registry and laid down a set of rules of procedure to govern the conduct of arbitration.

initial set up of an international tribunal[90]. Between 1911 and 1919 several plans were submitted by national and international bodies and governments for the establishment of a permanent international judicial tribunal after the war[91]. After 35 sessions the Committee of Jurists, which was convened by the Council of the League of Nations, adopted a draft scheme for the Statute of the Permanent Court of International Justice (PCIJ). These endeavours culminated in the creation of the PCIJ within the framework of the new international system after World War I by the League of Nations. The PCIJ started its operative work in 1922 and was dissolved in 1946.

a) The Chinn Case[92]

In Congo, then a colony of Belgium, a British citizen[93] established a transport business on the sea. The business was attached to a company, *Unatra*, with a majority of its shares held by the Belgian State itself. Because of the commercial depression in 1930/1931 the Belgian government decided to subsidize the export trade of Congo by decreasing tariffs for certain products up to 75 %. *Unatra* experienced a loss of profits in return and received compensation. As a result of this change of tariffs, the British citizen was unable to compete and closed down his business without receiving any reimbursement or compensation. Thereupon the United Kingdom, in consent with the Belgian government, submitted the case to the PCIJ raising the question whether the Belgian measures constituted a breach of international law. In its judgment, the court held the measures of the Belgian government to be in accordance with international law. In this respect, the *Convention of Saint-Germain-en-Laye* served legal basis for the judgment[94]. In the interpretation given the court stressed that the said convention would not oblige Belgium to create an atmosphere of equal commercial conditions[95]. Therefore alleging unlawful discrimination on behalf of its citizen by the British government could not prevail as *Unatra* was in a different position. In line with these findings the court held that the measures of the

90 The draft was not adopted at the Second Conference because of differences of opinion concerning issues of jurisdiction. The draft was attached to the Final Act of the 1907 Conference under the title „Projet d'une Cour de Justice Arbitrale".

91 These plans, sometimes in conjunction with plans for a world organization, were mostly based on initiatives of independent academic bodies, notably the British Fabians Society and the American Society for the Judicial Settlement of Disputes.

92 *Oscar Chinn* Case, Judgment, PCIJ, Series A/B, No. 63 (1934), p. 65-152.

93 *Oscar Chinn*, PCIJ, Series C, No. 75.

94 *Dolzer*, Chinn Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 579-580.

95 The court assumed that *Oscar Chinn* had been aware of the favourable position of *Unatra*, see Series A/B, No. 63 (1934), p. 69.

Belgian government in question did not result in a violation of vested rights[96]. The judgment received much attention due to its pronouncements on expropriation and discrimination, although the court's understanding of these terms hardly mirrors the current approach to international law in this respect.

b) The Mavrommatis Palestine Concessions Case[97]

The Permanent Court of International Justice also addressed the issue of diplomatic protection in the *Mavrommatis Palestine Concessions Case*[98]. Before World War I, a Greek national, *Mavrommatis*, signed two agreements with the Ottoman Empire, on concessions for the construction and exploitation of works necessary for the distribution of public electricity and water in Palestine. After the beginning of World War I the parties of the agreements postponed their execution. After the peace settlement process *Mavrommatis* addressed the government of Palestine with the question when to put the concessions into operation. According to the Peace Treaties signed after World War I, the Allied Powers should continue to enjoy the rights acquired in Palestine before the beginning of World War I. In addition, Great Britain was entrusted with the mandate for Palestine. For this reason the British government concluded an equivalent agreement with another applicant, which provided for the right of the applicant to require the expropriation of any concessions conflicting with his rights. *Mavrommatis* continued to submit plans for execution of the concessions to the British government, but when these were eventually rejected, he claimed restitution for violation of his rights.

On behalf of its national, the Greek government exercised diplomatic protection by addressing the PCIJ with an application to institute proceedings against the British government. The court accepted jurisdiction after rejecting objections regarding the issue of jurisdiction raised by the British government[99]. In its judgment the court

96 The court excluded the possibility of making profit from the scope of protection of vested rights, stating that „Favourable business conditions and good-will are transient circumstances, subject to inevitable changes …", see Series A/B, No. 63 (1934), p. 88.

97 *Mavrommatis Concession Case*, PCIJ, Series A, No. 5 (1925); *Doehring*, Mavrommatis Concessions Case, in Encyclopedia of Public International Law, in *R. Bernhardt* (ed.), vol. III, (1981), p. 330 (332).

98 See PCIL, Series A, No. 25 (1925).

99 See PCIL, Series A, No. 25 (1925), Judgment of 8 August 1924 (PCIJ A 2).

held that *diplomatic protection* was an elementary principle of international law[100]. Thus, in the judgment the court found that *Mavrommatis* was entitled to require that the concessions were being readapted to the new economic conditions, but not to compensation payment[101]. After two years, the Greek government submitted another application alleging the breach of international obligations by the British government as it refused to approve new plans submitted by *Mavrommatis* on 5 May 1926 until December 1926. In return, the British government repeated its objections against jurisdiction of the PCIJ as without the express consent of both parties, the Court could not claim jurisdiction to decide whether one of its judgments had or had not been complied with. In addition, the government denied the violation of international obligations within the meaning of the respective mandate. In its judgment[102] the court upheld the objections alleged by the British government on the question whether it had jurisdiction to supervise the fulfilment of terms of a previous judgment. Moreover, the court emphasized the exhaustion of local remedies as a substantial requirement for the application of the rules of *diplomatic protection*[103]. The 1925 judgment contributed therefore to the development of the rule of diplomatic protection. In particular the affirmation of the concept of *diplomatic protection* was considered a huge step forward in the context of foreign investment protection by general international law.

2. The International Court of Justice

After World War II a system for the peaceful settlement of disputes should be set up including an international judicial institution[104]. As a consequence thereof, it was agreed upon convening a "United Nations Conference on International Organization". At the Yalta Conference in 1945 the statute for an international court was

100 See PCIL, Series A, No. 25 (1925), p. 6, para 12: "[i]t is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State; in so doing, a state was in reality asserting its own rights … [For] in the eyes of [an international tribunal] the State is the only claimant", the entire judgment is also available at <http://www.icjcij.org/cijwww/cdecisions/ccpij/serie_A/A_02/06_Mavrommatis_en_Palestine_Arret.pdf>. The dictum was repeated by the Permanent Court of International Justice in the *Panevezys Saldutiskis Railway* Case (Estonia v. Lithuania), P.C.I.J. Reports (1939), Series A/B, No. 76, p. 16.

101 See PCIL, Series A, No. 5, Judgment of 26 March 1925 (PCIJ A 5).

102 Readaption of the *Mavrommatis Palestine* Concessions, PCIJ, Series A, No. 11 (1927), judgment of 10 October 1927 (PCIJ A 11).

103 *Mavrommatis Concession* Case, PCIJ, Series A, No. 5 (1925), p. 6 at para 12 of the 1924 judgment.

104 *Jessup*, Do New Problems Need New Courts?, American Journal of International Law, vol. 65 (1971), p. 261-268; for a short survey see *Tornaritis*, The review of the Role of the International Court of Justice, revHellen, Vol 24 (1971), pp. 34; *Lillich*, The deliberative Process of the International Court of Justice, A Preliminary Critique and Some Possible Reforms, American Journal of International Law, vol. 7 (1976), p. 28.

drafted which was modelled on the Statute of the PCIJ, as most provisions were taken verbatim from the revised version. The Statute of the International Court of Justice (ICJ)[105], the "World Court", was adopted in conjunction with the Charter of the United Nations on 26 June 1945 and came into force on 24 October 1945. So far, the ICJ has only infrequently been confronted with investment disputes: Yet, the court rendered two post-war[106] leading decisions. As only states can appear before the ICJ, the claims were espoused by the states on behalf of their nationals. These two decisions continue to be of outstanding importance in the context of the development of foreign property protection by international law: (1) The *Barcelona Traction, Light and Power Co. Ltd. (Belgium v. Spain)* Judgment[107] of 1970 and (2) the *Elettronica Sipula S.p.A. (USA v. Italy)* Judgment[108] of 1989.

a) The Barcelona Traction Case

The foundations of property protection were indirectly addressed in the ICJ decision in *Barcelona Traction* in connection with matters of diplomatic protection of legal persons. Belgian nationals, both natural and legal persons, were shareholders of a Canadian holding company, the *Barcelona Traction, Light and Power Company Ltd.* The company issued several series of bonds, partly in pesetas and sterling. In context with the Spanish civil war the bonds interest payments were refused and not resumed. Spanish shareholders submitted a petition for a declaration on bankruptcy which was followed by the Spanish courts and the assets of the company were seized. Various legal actions against the declaration of bankruptcy remained unsuccessful. In 1951 the corporate capital was sold entirely in the shape of new shares at

105 According to Article 92 of the Charter of the United Nations, the International Court of Justice is established as the "Principal judicial organ of the United Nations."

106 One of the most famous Pre-War Court Decisions together with the *Oscar Chinn* Case and the *Mavrommatis Palestine* Concession Case was the Case concerning *Chorzow Factory*, PICJ, Ser. B, No. 3 (1925), p. 1-36, which dealt with the issue of restitution in international law. The dictum affirmed the idea of restitution as a primary remedy in international law. The court stated in its judgment that "the essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral decisions – is, that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear", see PICJ Series A, No. 17 at 47, which resulted in a pronouncement on the responsibility of the host state to foreign investors. The judgment is also available at <http://www.worldcourts.com/pcij/eng/decisions/1927.07.26_chorzow/>.

107 *Barcelona Traction, Light & Power Co. Ltd* (Belgium v. Spain), ICJ Reports, 1970 I.C.J. 3, 42, 42-50 (Feb 5); see also Wallace, Barcelona Traction Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 346-349.

108 *Elettronica Sicula S. p. A.* (ELSI), Judgment, ICJ Reports (1989), p. 115-121, available at <http://www.icj-cij.org/icjwww/icases/ielsi/iels.ijudgments/icsli.ijudgment19890720.pdf>.

public auction and purchased by a Spanish company. The Belgium shareholders did not receive any reimbursement or compensation for their loss.

Belgium applied to the ICJ[109] and alleged reparation for the damage caused "on account of acts said to be contrary to international law committed by organs of the Spanish State", including "the deprivation of the enjoyment of rights", and leading to the "total spoliation of the Barcelona Traction group."[110] In return, the Spanish government raised objectives regarding the discontinuance of the proceedings, but also a lack of *jus standi* of Belgium and the exhaustion of local remedies. The court acknowledged that Belgium was acting on behalf of natural and legal persons, but followed the last two arguments of the Spanish government[111]. The decisive factor in this context was whether the Belgian government was entitled to provide diplomatic protection for the Belgian shareholders though their losses resulted not from an injury to the "direct rights" of the nationals[112]. The final judgment rendered rejected the claims of Belgium on the grounds of lacking *jus standi* [113] and concluded the application of diplomatic protection only to be granted when exceptional circum-

109 ICJ Pleadings, *Barcelona Traction*, Light and Power Company Ltd. (Application 1958); New Application 1962, vols. I-X.

110 The application was discontinued when in 1961 Belgium attempted to negotiate an out-of-court settlement, which was objected by the Spanish government. The case was submitted to the ICJ by a new application of Belgium in 1962.

111 See para 102 of the judgment. In addition, the court denied any analogy with regard to the *Nottebohm* Case, Judgment, ICJ-Reports 1955.

112 The court stated in this respect that "…an act directed against and infringing only the companys rights does not involve responsibility towards the shareholders, even if their interests are affected. … The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law orders confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action", see *Barcelona Traction* Case, ICJ Reports (1970), p. 36, paras. 46-47; see also p. 33, where the court held that „From its origins closely linked with international commerce, diplomatic protection has sustained a particular impact from the growth of international economic relations, and at the same time from the profound transformations which have taken place in the economic life of nations".

113 In this respect, the court stated "that the adoption of the theory of diplomatic protection of shareholders as such, by opening the door to competing diplomatic claims, could create an atmosphere of confusion and insecurity in international economic relations. The danger would be all the greater inasmuch as the shares of companies whose activity is international are widely scattered and frequently change hands;" *Barcelona Traction* Case, ICJ Reports 1970, p. 4; separate opinions of Judge *Jessup* paras 44-57, 80 and Judge *Gros*, paras 22, 24.

stances occur[114]. Likewise, the principle of diplomatic protection of corporations was clarified in the sense that a corporation is to be protected by the State of nationality of the corporation and not by the State or States of nationality of shareholders in a corporation[115]. The decision met heavy and well-founded criticism which was based mainly on the argument that "the court seems to have raised a host of complex issues and to have resolved almost none"[116]. The opportunity to clarify and develop legal standards in international commercial litigation and in international law in general had not been taken[117].

b) The Case concerning Elettronica Sicula S.p.A. (ELSI)[118]

The *Barcelona Traction Case* set the climate for the court decision concerning *Elettronica Sicula S.p.A.* (*USA v. Italy*): A company founded in Palermo/Italy, the *Raytheon ELSI S.p.A.* was owned almost entirely by an American company, the United

114 "In allocating corporate entities to States for purposes of diplomatic protection, international law is based, but only to a limited extent, on an analogy with the rules governing the nationality of individuals. The traditional rule attributes the right of *diplomatic protection* of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office. These two criteria have been confirmed by a long practice and by numerous international instruments. This notwithstanding, further or different links are at times said to be required in order that a right of diplomatic protection should exist. Indeed, it has been the practice of some states to give a company incorporated under their law *diplomatic protection* solely when it has its seat or management or centre of control in their territory, or when a majority or a substantial proportion of the shares has been owned by nationals of the state concerned. Only then, it has been held, does there exist between the corporation and the state in question a genuine connection of the kind familiar from other branches of international law. However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the genuine connection has found general acceptance. Such tests as have been applied are of a relative nature, and sometimes links with one State have had weighed against those with another." *Barcelona Traction* Case, ICJ Reports (1970), p. 4 at paras 32, 33, 42 and p. 48, para 92, where the court stated that "it is quite true that it has been maintained that, for reasons of equity, a State should be able, in certain cases, to take up the protection of its nationals, shareholders in a company which has been the victim of a violation of international law. Thus a theory has been developed to the effect that the state of the shareholders has a right of diplomatic protection when the state whose responsibility is invoked is the national state of the company. Whatever the validity of this theory may be, it is certainly not applicable to the present case, since Spain is not the national State of *Barcelona Traction*".

115 See *Barcelona Traction* Case, ICJ Reports 1970, p. 34, paras 40 - 44.

116 *Wallace*, Elettronica Sicula Case, in *R. Bernhardt* (ed.), Encyclopedia of Public International Law, vol. I (1992), p. 348; in addition it was mentioned that the court in Barcelona Traction was guided by a number of policy considerations, see *ibid*. p. 48-49, paras 94-96, p. 48, paras 94, 95, p. 38, para 53, p. 50, para 98.

117 This suggestion is in accordance with the evaluation of Judge *Fitzmaurice* who stated that „general international law obligations in the sphere of the treatment of foreigners" have not been clarified, see separate opinion of Judge *Fitzmaurice*, ICJ-Report 1064, p. 65.

118 *Elettronica Sicula S.p.A.* (ELSI), Judgment, ICJ Reports (1989), p. 15-121.

States *Corporation Raytheon Company* and its subsidiary *The Machlett Laboratories*. Due to a continuing financial crisis of ELSI, the government of Italy was asked to provide subsidies or other governmental support to the company in order to avoid liquidation. After a refusal of the Italian authorities, representatives of Raytheon provided support for an orderly liquidation. The liquidation was prevented by an order released by the Mayor of Palermo which determined the requisitioning of ELSI's assets[119]. In response, ELSI submitted a petition for bankruptcy. ELSI was purchased by a state-controlled subsidiary substantially below its book value. In 1974 the United States of America declared to exercise diplomatic protection on behalf of *Raytheon* and *Machlett.* The U.S. government alleged violations of a bilateral treaty between the United States of America and Italy[120]. Pursuant to Article XXVI of this treaty, the ICJ had jurisdiction and thereupon the case was submitted to the court in February 1987. Italy argued that local remedies had not been exhausted, as the actions before the Italian courts had not been based on provisions of the bilateral treaty. In this respect, the court addressed the rule of customary law requiring the exhaustion of local remedies and found that the rule is "an important principle of customary international law"[121]. The ICJ acknowledged jurisdiction but then rejected the case[122] while discussing the scope of certain standards provided by the treaty[123]. The decision remained, in this respect, to be based mainly on a debatable evaluation of the facts[124]. Nevertheless, the ELSI decision had remarkable impacts on the development and interpretation of BITs, but, as before, the ICJ deprived itself of the opportunity to shape and construe international customary law.

119 The representatives of ELSI raised an appeal against the order immediately. The Prefect of Palermo declared the actions of the Mayor to have exceeded his power, but the decision was issued more than a year later.

120 The respective treaty is the Treaty of Friendship, Commerce and Navigation, concluded on 2 February 1948.

121 ELSI case, I.C.J. reports 1989, p. 15 at p. 42, para. 50. In this respect the Court also stated that "the local remedies rule does not, indeed cannot, require that a claim be presented to the municipal courts in a form, and with arguments, suited to an international tribunal, applying different law to different parties: for an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success."

122 The Court stated that "in the present state of the law, the protection of shareholders requires that recourse be had to treaty stipulations or special agreements directly concluded between the private investor and the State in which the investment was placed. States even more frequently provide for protection, (…), either by means of special instruments or within the framework of wider economic agreements. (…) No such instrument is in force between the Parties to the present case."

123 The Court discussed primarily Art. III and Art. V of the bilateral treaty, but dismissed the claims put forward by the United States in context with these articles.

124 See *Wengler*, Die Entscheidung des IGH im „ELSI"-Fall, Neue Juristische Wochenschrift, vol. 43, (1990), p. 619 (620).

3. Summary

The court decisions rendered by international tribunals in the area of foreign investment protection and presented in the section above mirror the developments carried out by international jurisprudence. Principles such as the exhaustion of local remedies[125] and the rule of diplomatic protection[126] were affirmed and cleared by dictums of the courts in the context of cases concerning foreign property protection. Nevertheless, most applicants before the international courts aimed at an award of restitution or the payment of compensation, but in particular the award of restitution has always been considerably rare in the jurisprudence of the World Court[127], which represents the main reason for the insignificance of the jurisprudence of the World Court in the area of foreign investment protection.

C. The Role of Human Rights Institutions

As foreign investment protection is fundamentally based on the idea of property, the protection of alien property forms an integral part of foreign investment protection in international law. In the past the protection of foreign property by human rights institutions was carried out by the instrument of classical diplomatic protection. In the early years of international law the individual had no own rights in the international legal order. As a consequence thereof, the protection of a national abroad was to be done only by means of the fiction underlying the instrument of diplomatic protection: that the home state was asserting its own rights[128]. A large number of treaties concluded by human rights institutions reflected the traditional approach to the rule of diplomatic protection and reciprocity as rules of international law. After World War II a new type of human right treaty was launched. The most significant characteristic of this treaty type is to grant the treaty rights to all individuals regardless of factors such as nationality[129]. By the emergence of a generation of treaties granting human rights to all individuals[130], human rights institutions formed a new conceptual understanding of the rule of diplomatic protection and diplomatic protection in terms of the classical conceptual understanding became largely superfluous.

125 See *Mavrommatis Palestine Concessions* Case, PCIL, Series A, No. 25 (1925).

126 See *Elettronica Sicula S. p. A.* (ELSI), Judgment, ICJ Reports (1989).

127 *Gray*, The Choice between Restitution and Compensation, European Journal of International Law, vol. 10 (1999), p. 413 (416).

128 In accordance with the traditional approach in international law an individual is a mere part of his home state and therefore cannot assert rights out of an international treaty. The State has the exclusive procedural right to decide on the material right on the international plane.

129 The European Convention on Human Rights (1950), the American Convention on Human Rights (1969) and the United Nations Human Rights Covenants (1966) represent the new generation of human rights treaties.

130 See *e. g.* Article 24 and Article 44 of the European Convention of Human Rights.

The new approach to the protection of the individual absent of classical diplomatic protection led to the emancipation of the individual from his home state under human rights conventions[131].

Given the existence of an absolute right to property, the investor would receive protection in absolute terms. Yet, there is no uniform understanding of property as an absolute right[132], because the concept is placed uneasily between distinct constitutional systems recognised in different parts of the world, one emphasizing the social function of property while the other follows the conceptual approach of an absolute right[133]. International human rights law concerning the protection of alien property needs to balance these divergent approaches, thus the international human rights law does not prohibit all forms of interferences with foreign property, as e. g. limitations on grounds of public good are lawful. The following section contributes to the protection of foreign property by human rights institutions by introducing and evaluating the applicable mechanisms.

I. Universal Human Rights Systems

Since World War II, in particular, human rights have achieved universal recognition and constitute a major concern of international law, but the first acknowledgement of the right to property as an internationally protected human right dates back to 1929 when the "*Institut de Droit International*" established in its "*Declaration des droits internationaux de'l homme*" the right to property as a human right[134]. Henceforth, by international agreements concluded on the universal level, international human rights law has created obligations upon States to recognize, respect and ensure these rights subject to their jurisdiction and to provide remedies in case of breach of obligations[135]. The international law of human rights includes a number of comprehensive international human rights treaties of which the *International Covenant on Civil and Political Rights* (ICCPR) is the principal instrument and the *Uni-*

131 *Geck*, Diplomatic Protection, in *R. Bernhardt* (ed.) Encyclopaedia of Public International Law, vol. I, (1992), p. 1059 (1060).

132 *Seidl-Hohenveldern*, Aliens Property, in *R. Bernhardt* (ed.), Encyclopedia of International Law, Vol. I, (1992), p. 118.

133 In the Commonwealth and the European systems of law the idea of property is that all individual property exists only to the extent that the interests of the society as a whole will permit it.

134 "Il est du devoir de tout Etat de reconnaitre a tout individu le droit égal a la vie, a la liberté et a la propriété, et d'accorder a tous, sur son territoire, pleine et entière protection de ce droit…"; see *Dolzer*, Eigentum, Entschädigung und Enteignung im geltenden Völkerrecht (1985), p. 127 (128).

135 Like all international agreements a human rights covenant or convention gives rise to remedies in favour of other State parties, and generally in favour of all other State parties equally; see for a general survey *Henkin*, Human Rights, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1992), p. 886-893.

versal Declaration of Human Rights is the accepted general expression of recognized human rights[136].

1. The Universal Declaration of Human Rights

In 1945 the Preparatory Commission of the United Nations recommended to the General Assembly to establish a Commission of Human Rights. The task of this body was to formulate an "International Bill of Rights"[137]. This proposal was followed and the United Nations Economic and Social Council (ECOSOC) established a Commission on Human Rights on 15 February 1946[138] and instructed the United Nations Secretariat to prepare a documented outline of the bill. Finally, on 10 December 1948, the United Nations General Assembly adopted the pertinent resolution as the Universal Declaration of Human Rights[139]. For the first time a common comprehensive international standard which should be guaranteed to every person was defined and the Declaration was the first enumeration, on the universal level, of human rights and fundamental freedoms. Thus it was proclaimed to be "an historic act, destined to consolidate world peace through the contribution of the United Nations toward the liberation of individuals from the unjustified oppression and constraint to which they are to often subject"[140]. Hence, it was agreed from the beginning, the Declaration should be followed by a binding convention to determine the implementation of the Declaration and establish an appropriate supervisory mechanism, the Covenant on Civil and Political Rights[141].

136 *Henkin*, Human Rights, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1995), p. 888; still, the human rights recognized in the Declaration or the Covenants are not declared to be absolute, as Art. 29 (2) of the Universal Declaration provides: „In the exercise of his rights and freedoms, everyone shall be subject only to such limitations as are determined by law, solely fort he purpose of securing due recognition and respect fort he rights and freedoms of others and of meeting the just requirement of morality, public order and the general welfare in a democratic society".

137 A draft of a proposed declaration was submitted by the representative of the United States which was modelled after the US Bill of Rights, see i. a. Department of State Bulletin, Dec. 7 1947, p. 1076; see also *Carrillo Salcedo*, Human Rights, Universal Declaration, in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. II (1995), p. 926.

138 It was decided that „the present Conference … could not proceed to realize such a draft … The Organization, once formed, could better proceed to consider the suggestion and deal with it through a special commission or by some other method. The Committee recommends that the General Assembly consider the proposal and give it effect", Documents of the United Nations Conference on International Organisation, San Francisco, 1945, vol. VI, p. 456.

139 UN General Assembly Resolution 217 (III); at that time, the United Nations had 56 members. 48 voted in favour, none against and 8 abstained.

140 See <http://www.udhr.org/history/A777.htm>.

141 As a resolution adopted by the General Assembly, the Universal Declaration of Human Rights is not in itself legally binding, but it is considered as an international standard and as such as part of the law of nations.

Some fundamental concepts constitute the basis of the Declaration: all human beings are born free and equal in dignity and rights[142], everyone is entitled to a social and international order in which the rights and freedoms set forth in the Declaration may be fully realized[143], and those rights determined in it apply to everyone without any form of discrimination whatsoever[144]. In Article 17 of the Declaration the right of every person to own property everywhere and of every kind is recognized[145], while the ownership of property is subject to the legislation and the laws of the respective country[146]. The issue of expropriation is addressed in the second paragraph, stating that "No one shall arbitrarily be deprived of his property"[147]. The wording of the provision is as general as Article 17 (1) and due to the vagueness much room is left for the application of national law.

2. The International Covenant on Civil and Political Rights

The International Covenant on Civil and Political Rights (ICCPR)[148] provides protection for an extensive catalogue of fundamental rights. The Covenant establishes a Human Rights Committee (HRC) consisting of eighteen members, who are independent experts being elected and nominated by the State Parties. These experts supervise the compliance of the Contracting Parties with the Covenant. They administer an optional inter-state complaint mechanism and consider individual petitions brought to the Committee pursuant to the ICCPR's First Optional Protocol[149]. The Committee is, however, not authorized to take any action but only to raise questions

142 See Article 1 of the Universal Declaration of Human Rights.
143 See Article 28 of the Universal Declaration of Human Rights.
144 See Article 2 of the Universal Declaration of Human Rights.
145 Article 17 reads that (1.) "Everyone has the right to own property alone as well as in association with others"; generally see also *Eide*, The Universal Declaration of Human Rights – A Commentary, (1992), Article 17 with further references.
146 See A7C.3/SR 126, p. 4, Art. 17. The drafting version contained an express reference explicitly referring to the situation under domestic law; it read: "the laws of the State in which the property is located", E/CN.4/AC.2/SR 8, p. 3. The reference was deleted during the drafting process.
147 Article 17 (2) of the Universal Declaration on Human Rights.
148 International Covenant on Civil and Political Rights, 16 Dec. 1966, entered into force 23 May 1976, G. A. Res. 2200A (XXI), U.N. Doc. A/6316 (1966), 99 U.N.T.S. 171.
149 Optional Protocol to the International Covenant on Civil and Political Rights, 16 December 1966, in force 23 March 1976, 999 U.N.T.S. 171.

with the reporting governments and make non-binding "general comments"[150] which the states that have accepted these optional procedures are expected to implement in good faith[151]. In addition, the ICCPR establishes the obligation for states to ensure that any person whose rights have been violated are entitled to "an effective remedy" and that it be determined by a competent authority. In case remedies do not exist, states must "develop the possibilities of judicial remedy" and ensure that it is afforded[152]. Mere formal incorporation of the treaty protections are considered insufficient if further measures such as developing new procedural guarantees or other legal institutions are required to bring them to full effect[153]. The right of property is not among the specific rights the Covenant grants, but it contains a non-accessory non-discrimination rule in its Article 26.[154] This rule determines equal treatment with regard to property between nationals and aliens. Reasonable and objective distinctions do not constitute a breach of Art. 26 ICCPR. Therefore specific distinctions are regarded as permissible differentiations. These permissible differentiations have been subject of decisions concerning foreign property protection.

The *Benes*-Decrees[155], issued in context with expropriations in the Czech Republic[156], gave rise to several communications to the Human Rights Committee. The

150 Under the ICCPR's Optional Protocol, following consideration of an individual complaint, the "Committee shall forward its views to the State Party concerned and to the individual", see Article 5 (4) First Optional Protocol to the ICCPR. Under the inter-state procedure, in cases where a solution is agreed to by the alleged violating party, the HRC shall "confine its reports to a brief statement of the facts and the solution reached." Where no solution is reached, "the Committee shall confine its report to a brief statement of the facts; the written submissions and record of the oral submission made by the State Parties concerned shall be attached to the report". In either scenario, the reports are issued to the State concerned.

151 VII United Nations, Blue Book Series, The United Nations and Human Rights 1945-1995, 61 (1995).

152 Article 2 (3) ICCPR.

153 Furthermore, Article 50 ICCPR obliges all parts of federal states to comply with the treaty provisions: "The provisions of the present Covenant shall exceed to all parts of federal states without any limitations or exceptions."

154 See e.g. Article 26 ICCPR.

155 The *Benes* Decrees are a series of decrees which were rendered during World War II and a short period after by the then President of Czechoslovakia, *Edvard Benes* who, as head of the Czechoslovak government-in-exile, exercised emergency powers from London and continued to do after his return Czechoslovakia at the end of World War II, see Europeans Parliament Resolution on the Czech Republic's application for membership of the European Union and the states of negotiations (Official Journal C 72 E of 21 March 2002. The following Decrees related to property and its confiscation. (a) Decree 5/1945 (19.5.1945) – Invalidity of certain property-related acts effected in the period of non-freedom; (b) Decree 12/1945 (21.6.45) – Confiscation and expedited distribution of agricultural properties of Germans, Hungarians, traitors and collaborators and certain organisations and institutes; (c) Decree 28/1945 (20.7.1945); (d) Decree 108/1945 (25.10.1945) Confiscation of enemy property and the national renewal funds.

decrees, formally still in force, claimed collective World War II responsibility of Germans and Hungarians living in Czechoslovakia. Persons belonging to these minority groups were deprived of many of their rights, in particular as concerned their property rights[157] and then expelled. Austria, Germany and Hungary have called for the repeal of the decrees. The legal validity of the decrees, though issued by an executive authority, has been approved[158] and the Czech Republic views the *Benes* Decrees as the basis of post-war Czechoslovak and later Czech legislation[159]. The Committee found in this respective that the restitution procedure as practised by the Czech Republic was in violation of Article 26 ICCPR, as it was based on the double requirement of Czechoslovak citizenship and permanent residency in the state's territory[160].

156 By virtue of the *Benes*-Decrees, 2.5 million ethnic Germans (*Sudetendeutsche*) and approximately 40.000 Hungarians lost their Czechoslovak citizenship, their landed properties due to expropriation measures based on the decrees and were exiled. These measures were carried out between 1945 and 1946.

157 Decree 12/1945 related to "the confiscation and accelerated allocation of agricultural property of the German and Hungarian persons and of those having committed treason and acted as enemies of the Czech and Slovak people."

158 The *Benes* Decrees were ratified by Constitutional Act No. 57/1946 of 28 March 1946, which states that "the Provisional National Assembly passed this Act to approve and declare as law the presidential decrees […] All presidential decrees were to be regarded as laws from the very beginning and constitutional decrees were to be regarded as constitutional acts."

159 The Czechoslovak Republic was transformed into the Czech Republic and the Slovak Republic on 1 January 1993. The legislation of the former Czechoslovak Republic maintained its legal validity after the transformation process.

160 UN Human Rights Committee, Communication No. 516/1992 *Simunek v. Czech Republic*, Nr. 516, para 11.6; confirmed in *Adam v. Czech Republic*, Nr. 586/1994, para 12.6; and *Blazek v. Czech Republic*, Nr. 857/1999, para. 5.8; see also *Des Fours Walderode v. Czech Republic*, Nr. 747/1997, para. 8.4.

The case *De Fours Walderode et al. v. the Czech Republic*[161] which was submitted to the Committee in 2001 is characterized by very specific facts: The applicant was born in 1904 in Vienna and a citizen of the Austrian-Hungarian Empire, but his family had settled in Bohemia since the 17th century, which was a kingdom of the empire. After the end of the First World War the applicant, as a resident of Bohemia, became a citizen of the newly created Czechoslovak State in 1918. Due to his German mother tongue his citizenship was automatically changed into German citizenship in 1939 by virtue of *Hitler's* decree of 16 March 1939. After the death of his father in 1941 he inherited property, the *Hruby Rohozec* estate, which was confiscated on the basis of *Benes* decree 12/1945 by the newly formed government and he was deprived of his citizenship which he retained some years later on account of his proven loyalty during occupation. After in 1948 a Communist government came into power the applicant was forced to leave Czechoslovakia in 1949 and returned to Prague only in 1991 after the "*velvet revolution*" of 1989 had taken place. He retained his Czech citizenship in 1992 and subsequently, on the legal basis of Restitution Law No. 243/1992 he reclaimed possession of the estate he had inherited from his father in 1941. The respective restitution law was amended in 1996 by replacing the condition of permanent residence by the condition of uninterrupted Czech/Czechoslovak citizenship from the end of the war until 1 January 1990. As consequence, the restitution agreement of 1992 was invalidated and could not serve as the legal basis for restitution, since the applicant has not maintained continuous citizenship. Notwithstanding his reacquisition of Czechoslovak citizenship the applicant has not received any restitution for the loss he suffered. In 2000 the applicant died but his wife pursued the claim.

The Committee found that the amendment of Law No. 243/1992 by the Law No. 30/1996 implemented a more stringent requirement of citizenship, since citizenship had already been required as a condition for restitution under Law No. 243/1992.

161 See UN Human Rights Committee, Communication No. 747/1997 on 30 October 2001, UN Doc. CCPR/C/73/D/7477/1997, *Dr. Karel Des Fours Walderode v. The Czech Republic*, CCPR/C/73/D/747/1997: 8.4. The Committee recalls its views in cases No. 516/1993 (*Simunek* et al.), 586/1994 (*Joseph Adam*) and 857/1999 (*Blazek* et al.) that "a requirement in the law for citizenship as an obligatory condition for restitution of property confiscated by the authorities makes an arbitrary, and, consequently a discriminatory distinction between individuals who are equally victims of prior state confiscations, and constitutes a violation of Article 26 of the Covenant. This violation is further expressed by the retroactive operation of the impugned Law. 9.1. The Human Rights Committee, acting under Article 5, paragraph 4, of the Optional Protocol, is of the view that Article 26, in conjunction with Article 2 of the Covenant, has been violated by the State Party. 9. 2 In accordance with Article 2, paragraph 3 (a) of the Covenant, the State Party is under an obligation to provide the late author's surviving spouse, Dr. *Johanna Kammerlander*, with an effective remedy, entailing in this case prompt restitution of the property in question or compensation therefore, and, in addition, appropriate compensation in respect of the fact that the author and his surviving spouse have been deprived of the enjoyment of their property since its restitution was revoked in 1995. The State party should review its legislation and administrative practices to ensure that all persons enjoy both, equality before the law as well as equal protection of the law".

The requirement of uninterrupted citizenship added by the amendment in 1996 led to an exclusion of the applicant and any others in that situation from restitution[162]. Therefore the Committee considered it discriminatory to require continuous Czech citizenship for someone who otherwise had the right to claim restitution of property confiscated on the basis of the *Benes* Decrees[163]. The Committee found that the measures carried out by the Czech government caused a violation of the non-discrimination rule of the Article 26 of the Covenant, since the Czech law discriminated aliens against nationals. Since the ICCPR does not grant the protection of property specifically, the non-accessory rule of non-discrimination has to serve as the legal basis for the equal treatment of aliens and nationals with regard to property protection. Nevertheless, the Committee renders only non-binding comments which are not enforceable and the implementation of these "views" is optional, thus proceedings before ICSID tribunals are far more effective and less time-consuming.

II. Regional Human Rights Systems

The three regional human rights conventions – European, American and African – are all cast in broad language to protect aliens as well as nationals[164] generally and

162 The Committee stated that "this raises an issue of arbitrariness and, consequently, of a breach of the right to equality before the law, equal protection of the law and non-discrimination under Article 26 of the Covenant", see No. 747/1997, § 8.3.

163 The Committee also ruled in favour of the applicant in the *Fabryova v. Czech Republic* case, when eligibility for compensation was denied while in similar cases the plaintiffs obtained restitution, see *Fabryova v. Czech Republic* (765/97), see *also Pezoldova* v. Czech Republic (757/97); the case of *Brok and Brokova* v. the Czech Republic was more controversial. The Committee observed that "legislation must not discriminate among the victims of the prior confiscation to which it applies, since all victims are entitled to redress without arbitrary distinctions", see No. 774/1997, § 7.3. The Committee found that the restitution laws of 1991 and 1994 "gave rise to a restitution claim of the author which was denied on the ground that the nationalization took place in 1946/1947 on the basis of *Benes*-Decree No. 100/1945 falls outside the scope of laws of 1991 and 1994. Thus, the author was excluded from the benefit of the restitution law although the Czech nationalization in 1946/1947 could only been carried out because the author's property was confiscated by the Nazi authorities during the time of German occupation. In the Committee's view this discloses a discriminatory treatment of the author, compared to those individuals whose property was confiscated by Nazi authorities without being subjected, immediately after the war, to Czech nationalization and who, therefore, could benefit from the laws of 1991 and 1994. Irrespective of whether the arbitrariness in question was inherent in the law itself or whether it resulted from the application of the law by the courts of the State party, the Committee finds that the author was denied his right to equal protection of the law in violation of article 26 of the Covenant", see *id*., § 7.4.

164 See Article 1 ECHR, stating that "the High Contracting Parties shall secure to everyone within their jurisdiction the rights and freedoms defined in Section I of this Convention".

with regard to property[165], although in detail, the wording of the respective clauses is not identical. The two more recent regional systems - the Inter-American and the African one - are modelled in part on the European Convention on Human Rights. The following chapter introduces and analyzes the three different systems and the respective jurisprudence to provide an overview on the human rights institutions playing a role on the regional level.

1. The European Convention on Human Rights

The drawing up of the Convention for the Protection of Human Rights and Fundamental Freedoms was set up by the Council of Europe and the Convention was opened for ratification in Rome on 4 November 1950[166]. It entered into force three years later in September 1953. The European Convention on Human Rights (ECHR) instituted the first regional Human Rights system. The Universal Declaration of Human Rights served as a model for the Convention and it was to pursue the beginning steps for a collective enforcement of certain rights set out in the Universal Declaration. The entry into force of the Convention was followed by fourteen protocols which have been adopted since. As amended further rights and liberties to those granted in by the Convention were added: Protocol 9 enables individuals to plead before the Court and now the Convention permits both states parties and individuals to bring communications against states adhering to the Convention. These developments led hand in hand with the accession of new Contracting States to an enormous increase of applications before the Court[167] which now functions on a permanent basis with full-time judges resident in Strasbourg. The European system was the first to establish an international court for the protection of human rights and a procedure for individual denunciations of human rights violations[168].

165 See *e.g.* the Preamble of the Inter-American Convention on Human Rights, which states that "the essential rights of man are not derived from one's being a national of a certain state, but are based upon attributes of human personality" and the Preamble of the African Charter: " … the reality and respect of peoples' rights should necessarily guarantee human rights".

166 See <http://www.echr.coe.int/Eng/Edocs/HistoricalBackground.htm>.

167 The number of applications registered by the Commission climbed from 404 in 1981 to 4750 in 1997 and the number of provisional files opened each year with the Commission overstepped 12000. After the implementation of Protocol 11 which came into force on 1 November 1998, the Court's case load increased at an unprecedented rate: the number of registered applications rose from 5979 in 1998 to 13858 in 2001, which equals an increase of approximately 130%. These circumstances were initiated to be resolved by a Ministerial Conference on Human Rights, which was held in Rome on 3 and 4 November 2000 to mark the 50th anniversary of the Convention. In 2004 44.100 new applications were lodged (a plus of 13% compared to 2003) and 32.500 applications were allocated to a decision body, at http://www.echr.coe.int/NR/rdonlyres/F2B964EE-57C5-4C86-8B8F-8B4B6095D89C/0/MicrosoftWordstatistical_charts_2004__internet_.pdf.

168 *Shelton*, Remedies in International Human Rights Law (2005), p. 108.

The drafting of a rule for the protection of property provided by the ECHR has been shaped by endless discussions and difficulties in finding a consensus on its formulation[169]. This difficulty is born almost entirely out of the historical background[170]: The preliminary version of the Convention did not contain any rule for the protection of property, but the Advisory Committee, an organ subsequent to the European Council endorsed the admission of a rule for the protection of property[171]. The proposal made in this respect by the Advisory Committee[172] was not backed on a broad basis by the Council, who then asked for an implementation of this guarantee in further amendments. This proposal was followed and the protection of property was introduced into Article 1 of the First Additional Protocol which entered into force on 20 March 1952[173]. Article 14 of the Convention prohibits any form of dis-

169 The members of the Council of Europe considered themselves sharing an "adequate common heritage of political traditions, ideals, freedom and the rule of law" to implement further certain of the rights contained in the Universal Declaration of 1948 (Cmd. 8969 (1953), p. 2); *Jacobs/White*, The European Convention on Human Rights (1996), p. 246; Due to the assertion of slavery and servitude, the protection of property was covered with oblivion; as in the International Covenant on Civil and Political Rights (1966), the term "property" appeared merely as a criterion of illegal discrimination; see further *Böckstiegel*, Die allgemeinen Grundsätze des Völkerrechts über Eigentumsentziehung, Eine Untersuchung zu Art. 1 ZP, 1963, p. 11; *Schwelb*, The Protection of the Right of Property of Nationals under the First Protocol, American Journal of Comparative Law, No. 12, 1964, p. 518; *Janis/Kay/Bradley*, European Human Rights Law (2000), pp. 16.

170 In addition, the protection of property rights as human rights raises particular problems, see generally *Schermers*, The international Protection of the Right of Property, in Protecting Human Rights: The European Dimension, in Essays in Honour of *Gerard J. Wiarda* (*Matscher/Petzold* ed.) (1988), p. 565.

171 See Travaux Préparatoires, vol. III (1976), p. 262.

172 «Toute personne, physique ou morale, a droit au respect de ses biens. Ses biens ne peuvent être soumis à confiscation arbitraire. Les présentes dispositions ne sauraient, toutefois, être considérées comme portant atteinte, de quelque manière que ce soit, au droit que possèdent les Etats de promulguer les lois nécessaires pour assurer l'utilisation de ces biens, conformément a l'intérêt générale».

173 See Article 1 of the First Additional Protocol of the European Convention on Human Rights which states the following: „ Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possession except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties." Due to the vagueness of the wording, difficulties regarding the interpretation of the Article arose, e. g. the general principles of international law that are referred to are the rules of general law on the expropriation of foreign property and not the general principles of international law recognised by civilised nations. Thus the requirement of compensation for expropriation, as postulated by international customary law, was incorporated in Article 1 of the First Additional Protocol.

crimination[174]. It must be stressed, however, that – in contrast to Article 26 ICCPR – Article 14 ECHR provides only for an accessory right to non-discrimination, i.e. only insofar as rights guaranteed in the Convention or any of its Additional Protocol are at stake. This situation has changed for those states for which Additional Protocol N° 12 which provides for a non-accessory right to non-discrimination similar to the one enshrined in Article 26 ICCPR has entered into force. The scope of the right established in the Additional Protocol is broadly framed and permissible restrictions are widely drawn. According to the Court, the respective Article in the Additional Protocol No.1 comprises three distinct, but connected rules[175], which are the peaceful enjoyment of property, the deprivation of possessions as subject to certain conditions and the right of the state to control the use of property in accordance with the general interest. The certain conditions which have to be met when deprivation of property is exercised have posed difficulties of interpretation[176]. The said conditions are *inter alia* the principles of general international law which refer to the principles which have been established in general international law with regard to the confiscation of property of aliens.[177] Therefore measures exercised by a state against its own nationals do not fall within the scope of these general principles of international law[178] and the nationals are in a different legal position from that of the alien[179].

The impact of the jurisprudence of the ECtHR on the protection of foreign investment might appear in a deceptive light, since foreign investment requires investment undertakings in another state than the national state of the investor and no such case has been decided before the ECtHR up to now[180]. Yet, the Court has given

174 According to Article 14, "the enjoyment of rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

175 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1421; *Jacobs/White*, The European Convention on Human Rights (1996), p. 247.

176 The European Convention on Human Rights accords priority to social interests over individual property rights, in particular when health and safety of the society at large are threatened by the recognition of the individual rights to property, in that sense also *Ruffert*, The Protection of Foreign Investment by the European Convention on Human Rights?, German Yearbook of International Law, vol. 43 (2000), pp. 117 (131), (139-141).

177 *Schwelb*, The Protection of Property of Nationals under the First Protocol to the European Convention on Human Rights, American Journal of Comparative Law (1964), No. 12, p. 518.

178 See App. *1870/63, X v. Federal Republic of Germany*, 16 December 1965 (1965) 8 Yearbook, 218, 226, where the Commission held that Article 1 of the First Additional Protocol does not require a state which deprives its nationals of their possessions in the public interest and subject to the conditions provided for by the law to pay compensation, see also *Lithgow and others v. United Kingdom*, Judgment of 8 July 1986, Series A, No. 102.

179 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1458).

180 *Schöbi*, Der Schutz des Eigentums in Europa, Recht - Zeitschrift für juristische Ausbildung und Praxis, vol. 18 (2000), p. 78; *Peukert*, Artikel 1 des Ersten Zusatzprotokolls, in EMRK Kommentar (*Frowein/Peukert* eds.), 1996, para 22 with note 67.

general interpretations to the text of the Article 1 of Protocol No. 1. In the Case *Sporrong and Lönnroth*[181] the Court ruled that the entitlement to the peaceful enjoyment of possessions means the right to hold property. According to the state of facts two properties had been affected by the existence of construction prohibitions and expropriation permits for many years without compensating the owners for their losses incurred during these periods. The interference with the propertys' function caused by the said regulations was considered not to equal a deprivation and the applicability of the second sentence of the first paragraph was denied[182]. The Court had to determine whether a fair balance was struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights[183]. It concluded, however, that the said balance was, as a requirement of proportionality, inherent in the whole of the Convention and concluded a breach of Article 1 of the First Additional Protocol[184].

In the Case *James v. United Kingdom*[185], the leading case on the issue of expropriation, the ECtHR held that the principles in question are applicable exclusively to aliens, because they were specifically developed for their benefit and, as such, they would not relate to the treatment of nationals by their own state[186]. The case concerned the loss of immovable property in Belgravia, London, by virtues of the leasehold reform in the late 1960s[187]. The Court reasoned that the reference to international law allowed non-nationals access to the implementation machinery of the Convention for property protection instead of seeking for diplomatic protection[188] and concluded that since non-nationals were considered more vulnerable to domestic legislation as they were not part of the electorate and could not influence the adoption of laws, nationals were imposed a greater burden in the public interest[189]. With regard to the standard of compensation the Court held that on the legal basis of Arti-

181 *Sporrong and Lönnroth v. Sweden*, Judgment of 23 September 1982, Series A, No. 52, 81983 5 EHRR 35.

182 *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1451).

183 *Sporrong and Lönnroth v. Sweden*, Judgment of 23 September 1982, Series A, No. 52, 81983, 5 EHRR 35, para 69.

184 In that sense also *Wiesinger v. Austria*, Judgment of 30 October 1991, Series A, No. 213 (1993) 16 EHRR 258, and *Holy Monasteries v. Greece*, Judgment of 9 December 1994, Series A, No. 301-A; *Gordon/Ward/Eicke*, The Strasbourg Case law – Leading Cases from the European Human Rights Reports (2001), p. 1422 (1453).

185 *James v. United Kingdom*, Eur. Court H.R., Judgment of 21 February 1986. Series A, No. 98, para 37.

186 See footnote 185, paras. 58-66.

187 See for a survey *Mendelson*, The United Kingdom Nationalisation Cases and the European Convention on Human Rights, British Yearbook of International Law, vol. 57 (1986), p. 33 (73).

188 *James* v. *United Kingdom*, Eur. Court H.R., Series A, No. 98, para 62.

189 See footnote 188, para. 63.

cle 1 of the First Additional Protocol a full compensation could not be guaranteed in every situation[190].

The *Wasa Liv Omsesidigt* Case[191] dealt with two companies which had brought an application against the Swedish government and alleged that its tax legislation concerning insurance companies constituted a breach of Article 1 of the First Additional Protocol. The European Commission rejected the case after finding that the application was ill-founded. In the *Darby* Case[192] the issue of taxation was also in the fore of attention, when a Finnish doctor resident in Sweden was taxed as a Swedish resident by the Swedish administrative authorities and therefore had to pay the entire church tax. He opposed these decisions and applied to the ECtHR, which rightly held that tax obligations fall within the scope of the second paragraph of Article 1 of the First Additional Protocol and opened the admissibility of considering a discriminatory effect of the Swedish tax regulations under Article 14 ECHR.

Another case concerning the issue of expropriation of foreign property was addressed in is the *Prince Hans-Adam II of Liechtenstein v. Germany* case[193]. The applicant initiated a claim *inter alia* for restitution of property, namely for a painting confiscated by the former Czechoslovakia in 1946 under *Benes*-Decree 12/1945[194] and alleged a violation of Article 1 of the First Additional Protocol[195]. He argued in this respect that the confiscation, as a violation of international law, had to remain ineffective. Challenging in particular the validity of the said expropriation, the applicant argued that, as heir, he was the owner of the painting concerned. In the applicant's submission, the restitution of the painting in question to the Czech Republic amounted to an unlawful interference with his "existing possessions". The confiscation of the painting by the former Czechoslovakia under *Benes* Decree No. 12 had been unlawful, since his father had been neither "German" nor an "enemy of the Czech and Slovak people" [196]. The applicant's father filed a claim, but on 21 November 1951 the Bratislava Administrative Court dismissed the appeal. In 1991 the municipality of Cologne obtained the painting as a temporary loan from the *Brno Historical Monuments Office* in the Czech Republic and the applicant requested for an interim injunction ordering to the City of Cologne to hand over the painting. He formed a file before the cologne Regional Court requesting for consent to the deli-

190 See above note, para. 54.

191 *Wasa Liv Omsesidigt v. Sweden*, 58 Eur. Ct. H.R. 163 (1988).

192 *Darby v. Sweden*, Judgment of 23 October 1990, Series A, No. 187; (1991) 13 EHRR 774; see also *Gasus Dosier und Fördertechnik GmbH v. The Netherlands*, Judgment of 23 February 1995, Series A, No. 306-B.

193 Eur. Court H. R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*; Application No. 42527/98.

194 Decree 12/1945 (21. 6. 1945) – Confiscation and expedited distribution of agricultural properties of Germans, Hungarians, traitors and collaborators and certain organisations and institutes, see Chapter C. I. 2.

195 The applicant also alleged a violation of Art. 6 (1) of the ECHR.

196 Eur. Court H.R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*; Application No. 42527/98, para. 79.

very of the painting. In several proceedings the German courts found they lacked jurisdiction and as consequence the applicant then filed an application before the ECtHR. The ECtHR dismissed a violation of property rights under Article 1 of the First Protocol on grounds of the scope of the term "possession"[197]. In this respect the Court stated "the hope of recognition of the survival of an old property right cannot be considered a "possession" within the meaning of Article 1 of Protocol No.1. In these circumstances, the applicant as his father's heir cannot, for the purposes of Article 1 of Protocol 1, be deemed to have retained a title to property nor a claim to restitution against the Federal Republic of Germany amounting to a legitimate expectation in the sense of the Court's case law. The Court thus concludes that there has been no violation of Article 1 of Protocol No. 1 and observes that the expropriation carried out by authorities of former Czechoslovakia in 1946, as confirmed by the Bratislava Administrative Court in 1951, that is before 3 September 1953, the entry into force of the Convention, and before 18 May 1954, the entry into force of Protocol No. 1. Accordingly, the Court is not competent *ratione temporis* to examine the circumstances of the expropriation or the continuing effects produced by it up to the present date"[198]. The ECtHR ruled that the *Benes* Decrees could not violate the ECHR and rejected the application.

As discussed above, both the Commission and the ECtHR have taken a broad view of the interpretation of Article 1 of the First Additional Protocol[199]. In this respect several judgments were rendered defining and clarifying its scope[200], but foreign direct investment has, up to now, not been addressed directly by the Court[201]. In addition, expropriation of a foreigner's property was uncommon among the traditional members of the members of the Convention[202] and the ECtHR is considerably reluctant to recognize the existence of an expropriation or any other

197 See also *Malhous v. the Czech Republic* (Dec.) No. 33071/96, 13 December 2000, ECHR 2000-XII and *Mayer & Others v. Germany* , application No. 18890/91, 19048/91 and 19549/92, Commission Decision of 4 March 1996, Decisions and Reports 85, p. 5-20.

198 Eur. Court H.R., Judgment of 12 July 2002, *Prince Hans-Adam II of Liechtenstein v. Germany*, paras. 79-87.

199 See ECHR of 23 September 1982, Series A752; *Sporrong and Lönnroth v. Sweden*: 60. "…Although the expropriation permits left intact in the law the owner's right to use and dispose of their possessions, they nevertheless in practice significantly reduced the possibility of its exercise. They also affected the very substance of ownership…The applicants' right of property thus became precarious and defeasible…the justification for the interference with the applicants' right of property", and ECHR on 18. February 1991, Series A/192, Fredin; ECHR on 19 December 1982, Series 0A/169, *Mellacher* and ECHR on 7. December 1976, Series A724.

200 Continuous jurisprudence since Eur. Court H.R., *Handyside* Case, Judgment of 7 December 1976, Series A, No. 24, para. 62; *Marckx* Case, Judgment of 13 June 1979, Series A, No. 31, para. 63.

201 See footnote 180.

202 *Böckstiegel*, Enteignungs- und Nationalisierungsmaßnahmen gegen ausländische Kapitalgesellschaften, Völkerrechtliche Aspekte, Bericht der Deutschen Gesellschaft für Völkerrecht, vol. 13 (1974), pp. 7.

measure which would result in restitution and/or compensation[203]. But in the last few years membership to the Convention has grown considerably, since all Central and East European States, including Russia and the Ukraine[204], joined it and its mechanism of judicial implementation. This development is taking place together with a vast boom of foreign direct investment in the Eastern parts of Europe and might increase the impact of regional human rights treaties, in particular the European Convention upon the protection of foreign direct investment.

2. The American Convention on Human Rights

The Inter-American system of human rights protection comprises thirty-four countries with a population of more than 600 million and is represented by the Organization of American States (OAS). The economical development and the distribution of wealth vary widely in this area[205]. The protection of human rights is based on a dual institutional structure, one having evolved from the Charter of the Organization of American States in 1948 and the other established by the entry into force of the 1969 American Convention on Human Rights in 1978[206]. Two independent organs safeguard implementation of the American Convention: In 1959 a Commission was set to serve as a mechanism for the protection of human rights, the Inter-American Commission of Human Rights. The Commission is vested with the authority to deal with allegations concerning a violation of human rights contained in either the American Declarations of the Rights and Duties of Man of 1948 or the 1969 American Human Rights Convention. The competence of the Commission was initially limited to give recommendations "with the objective to bring about more effective observance of Human Rights". In 1978 the American Convention on Human Rights came into force and incorporated the Commission. Moreover, it provided for the establishment of the Inter-American Court on Human Rights. The protection system under the American Convention still resembles the one previously applicable under the European Convention: Only a state concerned or the Commission can submit a case to the Court, provided, moreover, that the state concerned has accepted the Court's jurisdiction. The Court's judgments are binding, but without an enforcement mechanism comparable to the European system. Also in contrast to the European system, the OAS inter-state complaint mechanism is optional whereas the accep-

203 *Weber*, Menschenrechte (2004), p. 819.

204 *Waelde/Gunderson*, Legislative Reform in Transition Economics: Western Transplants – A short-cut to Social Market Economy Status?, International and Comparative Legal Quarterly, vol. 43 (1994), p. 347 *et seq*.

205 *Reisman*, Practical Matters for Consideration in the Establishment of a Regional Human Rights Mechanism: Lessons from the Inter-American Experience, St. Louis Warsaw Trans'l 89 (1995), p. 90-92.

206 American Convention on Human Rights, 22 November 1969, in force 18 July 1978, OEA/ser.L/V/II.23, doc. 21 rev. 6 (1979), O.A.S.T.S. No. 36 at 1.

tance of the individual petition procedure is mandatory for any State Party to the Convention[207].

The instrument preceding this Convention, the American Declaration on the Rights and Duties of Man[208], provided for property protection[209], adhered to the approach to the right of property as a human right and set a rule for compensation in case of expropriation[210]. The American Convention on Human Rights of 1969 contains rules for the protection of property in its Article 21[211] and according to Articles 24 and 25 the right to equal protection and the right to judicial protection. Article 44 states that juridical persons do not have the capacity to lodge petitions to the Commission[212]. In deciding not to entertain these kinds of petitions, the Commission is excluding a major part of the economic disputes potentially arising under the American Convention. Notwithstanding, a significant case in the context of foreign property protection is the case *Mevopal S. A.* v. Argentina[213]. *Mevopal S. A.*, a construction company, entered into three construction contracts with the Provincial Housing Institute in the Province of Buenos Aires. The contracts were breached in various respects and caused a loss of working capital for *Mevopal*. The company then filed various local suits, but the Argentine Supreme Court rejected the appeals filed. On behalf of *Mevopal* its legal representative filed a petition with the Inter-American Commission on Human Rights alleging *inter alia* the violation of property by the State of Argentina. The Commission found that it was lacking competence *ratione personae*, inasmuch as juridicial persons are not entitled to protection by the Convention and declared the petition inadmissible. Although the awards rendered by the

207 All states ratifying the convention accept the right of any person or group of persons, or any non-governmental entity legally recognized in one or more member states of the OAS to present petitions to the inter-American Commission, see Art. 44 of the American Convention on Human Rights.

208 The Declaration was accepted by the Ninth International Conference of the American States in 1948 in Bogota and is available at <http://www.oas.org/juridico/english/Treaties/b-32.htm>.

209 See Article XXIII: „Every person has a right to own such private property as meets the essential needs of decent living and helps to maintain the dignity of the individual and of the home."

210 „The States shall guarantee the right to private property, and its individual or collective use shall be subject to the interests of society, with respect at all times for the dignity of the individual and the inherent needs of family life. Expropriation shall be legal in cases of public utility or social interest, in which case compensation shall be made."

211 The Article states that "(1) everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interests of society. (2) No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law. (3) Usury and other forms of exploitation of man and by man shall be prohibited by law," see Inter-American Commission on Human Rights, Ten Years of Activity 1971-1981 (1982) 28.

212 Article 44 states that „any person or group of persons, or any nongovernmental entity legally recognized in one or more member states of the Organization, may lodge petitions with the Commission containing denunciations or complaints of violation of this Convention by a State Party."

213 Case *Mevopal, S.A. v. Argentina*, Report No. 39/99, Inter-Am. C.H.R. OEA/Ser. L./V./II.95 doc. 7 rev. 297 (1998).

Commission of the Convention entitle the claimant for compensation[214], it has little practical relevance in the field of foreign investment.

3. The African Charter on Human and People's Rights

The African Charter on Human and Peoples' Rights[215] was the last regional human right Convention entering into force[216]. It obliges its contracting parties to recognize the rights, duties and freedoms contained in the Charter and bring them to full effect by adopting the legislative or other measures required[217]. The Charter functions within the framework of the African Union (AU). It emphasizes African traditions and values, but also grants peoples' rights as well as individual rights, particularly referring to the right of development. Moreover, the Banjul Charter proclaims economic, social, cultural as well as civil and political rights. It protects private property as such[218], but not the owner. It reflects the specific attitude of the developing countries towards the right and protection of property as a fundamental right[219], but it determines no legal consequences in case of expropriation[220] and can therefore not provide a sufficient protection of property.

Pursuant to Article 30 of the Charter the African Commission on Human and People's Rights was founded which duties are to promote human and peoples' rights and ensure their protection in Africa[221]. The Commission consists of eleven independent members and has four functions explicitly conferred to it under the Charter: the promotion of human and peoples' rights in Africa, the protection of those rights and the interpretation of the Charter. The Commission is deemed to still explore the scope of its powers due to the short time of its being in function, but by the end of its

214 See Art. 68 (3) American Convention on Human Rights.

215 The Convention is originally called the *Banjul*-Charter, see African Charter on Human and People's Rights, adopted 27 June 1981, entered into force 21 October 1986, O.A.U. Doc. CAB/LEG/687/3 rev. 5, reprinted in (1982) 21 I.L.M. 58.

216 *Shelton*, Remedies in International Law (2005), p. 113; *Mugwanya*, Realizing universal human rights norms trough regional human rights mechanisms: reinvigorating the African System, Indiana International & Comparative Law Review, vol. 10, No. 1 (1999), p. 35-50.

217 See generally *Essien*, The African Commission on Human and People's Rights: Eleven Years After, 6 State University of New York at Buffalo School of Law Review 93 (2000), p. 93-111.

218 See Article 14 stating that „The right to property shall be guaranteed. It may only be encroached upon in the interest of public need or in the general interest of the community and in accordance with the provisions of appropriate laws."

219 *Dolzer*, Eigentum, Entschädigung und Enteignung im geltenden Völkerrecht (1985), p. 106.

220 See Article 14 (2) African Charter on Human Rights.

221 Before the adoption of the Protocol to the African Charter on Human and Peoples' Rights on the establishment of an African Court on Human and Peoples' Rights on 1 January 2004, the protection of rights listed in the *Banjul*-Charter was exercised solely by the African Commission on Human Rights, a quasi-judicial body, modelled on the United Nations Human Rights Commission with no power to adopt binding measures. The Commission's functions are limited to examine state reports or to interpret the Charter on request of a state party.

first decade it had concluded over 100 cases[222]. To make the African system for the protection of human rights more effective, a new mechanism was taken on in 1998[223]. The Protocol to the African Charter on Human and Peoples' Rights on the establishment of an African Court on Human and Peoples' Rights entered into force on 25. January 2004 upon its ratification by fifteen Member states[224] and resulted in the establishment of the African Court on Human and Peoples' Rights (ACHPR)[225]. It provides that the Court accepts actions on the basis of any instrument, including human right treaties, which have been ratified by state parties in question[226]. Individuals as well as NGO's may submit actions to the Court[227]. Moreover, the Court can apply as legal source of law any relevant human rights instrument ratified by the respective state[228]. While its judges have been recently elected, the permanent seat of the Court still has to be determined and its statute to be adopted in order to make it functionable[229].

222 See http://www.achpr.org/english/_doc_target/documentation.html?../activity_reports/activity-16_en.pdf>; *Quashigah,* The African Charter on Human and People's Rights, African Human Rights Law Journal, vol. 2, No. 2 (2002), p. 261-300.

223 *Ibid*.; *Nmehielle*, Towards an African Court of Human Rights: Structuring and the Court, 6 Annual Survey of International and Comparative Law 27 (2000), pp. 27 (29); *Udombana*, Toward the African Court on Human and Peoples' Rights: Better late than never, 3 Yale Human Rights and Development Journal (2000) 45; *El-Obaid/Kwadwo*, Human Rights in Africa – A New Perspective on Linking the Past to the Present, 41 McGill Law Journal (1996) 819; *Akinseye-George*, New Trends in African Human Rights Law: Prospects of an African Court of Human Rights, University of Miami International and Comparative Law, Vol. 10 (2001/2002), p. 159 (175)*; Krisch*, The Establishment of an African Court on Human and People's Rights, Zeitschrift für ausländisches öffentliches Recht und Völkerrecht, vol. 58 (1998), p. 713(733).

224 See <http://www.achpr.org/english/_doc_target/documentation.html?../ratifications/ratification_court_en.pdf>; *Wundeh Eno*, The Jurisdiction of the African Court on Human and Peoples' Rights, African Human Rights Law Journal (2002), p. 223-233; *Mubangisi*, An African Court on Human and People's Rights, South-African Yearbook of International Law (1999), pp. 256.

225 The Court should eventually be merged with the envisaged African Court of Justice the Charter of which has, however, not yet come into force; see further *Udombana*, An African Human Rights Court and African Union Court: A needful Duality or a needless Duplication?, Brooklyn Journal of International Law, vol. 28, No. 3 (2003), pp. 811.

226 See Art. 3. 1. of the Protocol.

227 See Occasional Paper, The African Court on Human and Peoples' Rights – Presentation , analysis and commentary: the Protocol of the African Charter on Human and Peoples' Rights, establishing the Court (2000), IA; further *Mohamed*, Individual and NGO Participation in Human Rights Litigation before the African Court of Human and People's Rights: Lessons from the European and Inter-American Courts of Human Rights, Journal of African Law 377(1999), p. 201-213; generally *Welch*, Protecting Human Rights in Africa: Strategies and Roles of Non-Governmental Organizations, University of Philadelphia Press (1995), pp. 279.

228 Art. 7 of the Protocol.

229 See <http://www.achpr.org/english/_doc_target/documentation.html?../activity_reports/activity1 6_en.pdf>.

III. Summary

The above considerations permit a brief evaluation of the role of human rights institutions in the context of foreign investment protection. While the traditional or classical concept of diplomatic protection in the sense of inter-state remedy has dominated the area of human rights protection until World War II, the new generation of treaties granting human rights to the individual has challenged this approach and improved the standing of individuals in international human rights litigation significantly. For instance, the ECHR and the African Court on Human and Peoples' Rights allow individuals to lodge claims against states who have expressly recognized the competence of the tribunals. The African Court on Human and Peoples' Rights also acknowledges human rights treaties concluded under the auspices of the United Nations as admissible sources of law; given the respective state is party to the treaty. The admissible application of the individual under the ECHR and the African Convention on Human and Peoples' Rights marks a great departure taken by these conventions from traditional forms of the international protection of individuals for they dispense with nationality as a condition of protection. Thus the developments in international human rights law show that the conceptual understanding of the rule of diplomatic protection had to face the winds of change resulting in a human rights protection system which is based on treaty law and limited to the means provided by the particular treaty. In sum, the principal achievement of contemporary human rights protection is to grant the same protection to all individuals regardless of their nationality or other factors, which can be pursued procedurally.

But there are two sides of the coin. Like all international law, human rights law is the law of the political system of nation states and subject to international political forces. The rights granted to the individuals by the respective treaties are not entirely covered by corresponding procedural rights in international law and it is not at all certain that the state parties intend to accept any international decision making and enforcement procedures for the protection of individual rights other than the ones provided for in the respective treaties. This is no coincidence but rather mirrors the underlying structural flaws of international law in general, which are to determine the amount of reparation to be paid to meet the requirements of an "adequate compensation" in each given case. Receiving an appropriate reparation payment in case of deprivation of property is a major factor to safeguard investment, in particular in a foreign country. Invoking a tribunal under the ICSID Convention provides these safeguards by a consistent and coherent jurisprudence rendered by experts as well as by binding awards. Its structural framework is tailor-made to meet these specific requirements and can therefore afford legal certainty by rendering consistent jurisprudence. The idea of the ICSID Convention at first line is to safeguard foreign property by providing a procedural framework in case of disputes, while human rights aim at the detachment of the individual from the state and a civilized conduct among states, including a non-discriminatory protection of property. Although, therefore, both concepts had the same basic purpose, namely the protection of the person and his property, they appear both in theory and in past practice as mutually

divergent. Ultimately, the exhaustion of local remedies remains a prerequisite for the application of diplomatic protection, which might be very time consuming and hinder alien investors from invoking human rights tribunals given that the ICISD Convention is ratified by the respective state. Otherwise international and in particular regional human rights courts might represent the last legal resort for the investor. An institutionalisation of the right of unilateral recourse to a remedy such as ICSID in treaties creating investment protection regimes represents a new approach to jurisdiction absent the local remedies rule and caters to the interests of foreign investors. If the system established under ICSID can overcome its current state of crisis, international human rights courts will not draw up level with tribunals under the ICSID Convention in the field of foreign investment protection.

D. The Role of the World Trade Organization

The following section examines the approach of the World Trade Organization (WTO) to foreign investment in order to draw conclusions on its current role as well as on its potential future prospects. Taking in account the close linkage between trade and investment, the WTO seems to be the appropriate venue for international investment protection, yet investment is the "missing panel" in the WTO's body of trade and trade-related agreements. Consequently, drafting a multilateral agreement on foreign investment protection under the auspices of the WTO has been on the agenda since the end of the twentieth century, when in the mid-1990s the Uruguay Round introduced an investment dimension in multilateral trade rules, bringing about new implications for foreign investment[230]. Notwithstanding this situation it is important to note that investment is, however, to some extent already covered by the WTO system, yet in a fragmented manner and dotted across a range of agreements. Foreign investment-related issues in that sense can now be found in five WTO agreements: the *General Agreement on Trade in Services* (GATS), the *Agreement on Trade-Related Investment Measures* (TRIMs), the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs), the *Agreement on Government Procurement* (GPA) and the *Agreement on Subsidies and Countervailing Measures* (ASCM)[231]. A single multilateral investment agreement on a comprehensive basis might be a clearly better approach, since the plethora of diverse bilateral and plurilateral agreements addressing foreign investment issues appears as a tangled web of competing and even conflicting commitments and potentially impairs foreign investment. Yet, significant objections were raised against the drafting of such a multi-

230 OECD, Working Papers on International Investment (2004), Relationship between International Investment Agreements, p. 3.

231 The ASCM is dealing with the prohibition of subsidies contingent upon domestic over foreign procurement and export performances. This has implications for access to investment incentives conditioned on performance requirements.

lateral agreement and none of the proposals made in this respect could successfully be implemented. Opposition against the idea of a multilateral comprehensive agreement within the WTO system was voiced mainly by developing countries which demanded, as a minimum, the introduction of exceptions, special treatment and escape clauses. It is true that investment law and trade law overlap substantially, but as they are heading at different achievements, introducing an investment agreement into the WTO system may be of debatable merit. To illustrate the circumstances surrounding the negotiations and drafting process of such a multilateral framework on foreign investment in the WTO, the development of the issue will be briefly described with an emphasis on the conflict provoking aspects of the drafting of a multilateral comprehensive investment agreement.

I. History

A glance at the history and the development of the WTO elucidates the background of the current situation: The Havana Charter in its version of 1947/1948, made for the International Trade Organization (ITO)[232], which was planned to come into effect along with other international institutions in this period of time, contained some provisions on foreign investment. Two articles of the Charter dealt with the issue of foreign direct investment and its protection[233]. One of these provisions was considered to give a preference to the developed states and was therefore severely objected to by the developing states. Ultimately, the Charter never came into force[234] and the ITO was whittled down to the provisions of the General Agreement on Tariffs and Trade (GATT)[235]. They contained rules on trade in goods and dealt with investment only peripherally. This setting was the initial situation for the separate development of international trade and investment in the system of the WTO.

During the Uruguay Round the issue of foreign investment was taken into consideration again and efforts were made to agree on measures regarding investment in international trade[236]. However, the Uruguay Round negotiations on trade-related investment measures were marked by strong disagreement among participants over

232 United Nations Conference on Trade and Employment, UNYB 1947-1948, 522 *et seq*.

233 Article 11 provided that no member "shall take unreasonable or unjustifiable action" against investment and determined "fair and equitable" treatment. Article 12 entitled the members to take appropriate safety valves against foreign investment and to "determine whether and to what extent and upon what terms it will allow future foreign investment".

234 *Schwarzenberger*, Foreign Investment and International Law (1969), p. 136 (137).

235 Dated 30 October 1947, in the version valid since 1 March 1969, UNTS 55, 94.

236 Ministerial Declaration of Punta del Este; see *Senti*, WTO – Regulation of World Trade after the Uruguay Round (1998), para 1143; *Shenkin*, Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT, Moving toward a multilateral investment treaty, University of Pittsburgh Law Review, vol. 55, No. 2 (1994), pp. 541; *Mashayeki/Gibbs*, Lessons from the Uruguay Round Negotiations on Investment, Journal of World Trade, vol. 33 (1999), pp. 1 (26).

the coverage and nature of possible new disciplines[237] and proved to be highly frustrating;[238] finally, the implementation of the TRIMS-Agreement was due to the decreasing interest of the U.S.A. on extensive investment liberalisation[239]. At the Ministerial Summit in Singapore in 1996 the WTO received the mandate to establish a "Working Group on Trade and Investment (WGTI)"[240]. The committee was to evaluate the feasibility of drafting a comprehensive regime on investment that could be administered by the WTO. Within the WGTI several aspects raised by the members of the Working Group were discussed during the first sessions. This check list of trade and investment contained the issues of the implications of the linkage between trade and investment for development and economic growth, in particular the economic parameters relating to macroeconomic stability, the degree of correlation between trade and investment flows and the determinants between this relationship as well as a stocktaking exercise regarding existing WTO provisions and implications for trade and investment flows of existing international instruments. The mandate was then renewed and specified at the Ministerial Summit in Doha in 2001[241]. The Doha Declaration announced commitment to the continuation of the WGTI and instructed the group to consider and clarify diverse issues, but is does not commit the WTO to formally launch comprehensive negotiations on a "General Agreement

237 Some developed countries made proposals for regulations that would prohibit a wide range of measures in addition to the local content requirements, which were found to be inconsistent with Article III in the *FIRA* panel case. Many developing countries raised objections and heavily opposed this approach.

238 *Croome*, Reshaping the World Trading System – a history of the Uruguay Round (1999), p. 116; <http://www.wto.int/english/thewto_e/whatis_e/eol/e/wto05/wto0f_3.htm#note4>.

239 The GATT rules only extend to a relatively narrow range of investment measures with direct and immediately identifiable impacts on trade. In the Uruguay Round of GATT negotiations, the United States in particular favoured a much more comprehensive GATT code on investment based upon the principle of free access to foreign markets. Unlike the United States, most other Contracting States were sceptical of the free access approach, and saw the task of the Uruguay Round negotiations on investment as that of developing more detailed and explicit rules with respect to measures that appear inconsistent with well-established GATT-principles, such as national treatment with respect to products, which would also require an extension of the kind of analysis to a broader set of measures such as trade balancing requirements or export performance requirements that directly affect trade flows.

240 *Stoll*, The World Trade Organization (WTO), in *R. Bernhardt* (ed.), Encyclopaedia of Public International Law, vol. IV (1999), p. 1541; *Gallagher*, Guide to the WTO and Developing Countries (2000), p. 67; for a later stage see generally *Correa/Kumar*, Protecting Foreign Investment, Implications of a WTO regime and policy options, (2003), p. 35 (50); a general survey is provided by *Sauve*, Qs and As on trade, investment and the WTO, Journal of World Trade, vol. 31, No. 4 (1997), p. 55 (79).

241 The Doha-Ministerial Declaration, 14. November 2001, WT/MIN(01)/DEC/1.

on Investment"[242]. In addition, the development issue was levelled into play and, in accordance with the Doha mandate the needs of the poorer states were to be taken into account within the considerations of the WGTI[243].

At Cancún in 2003, the EC's insistence on the launching of investment negotiations and the adamant stance of a large group of developing countries that investment should be put on hold were a major factor[244]. With neither the USA nor the EC prepared to support negotiations in the face of the developing countries resistance, investment is effectively off the table at the WTO for a foreseeable future, which is clearly reflected in the results of the Ministerial Summit in Hong Kong in December 2005[245].

II. The WTO Agreements

Currently, the five agreements mentioned above address issues of foreign investment in their provisions. This section introduces three of them: the *General Agreement on Trade in Services* (GATS), the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs) and the *Agreement on Trade Related Investment Measures* (TRIMs). The regimes appear to be not entirely compatible, as the GATS seeks to provide market access by its non-discrimination rules, addressing primarily macroeconomic issues, while the TRIPs focuses on the microeconomic aspects of foreign direct investment[246] and the TRIMs aims at prohibiting measures of WTO member states making the approval of investment conditional on compliance with any regulations that favour domestic products. This section explores the agreements and provides a short analysis and evaluation.

242 These issues were *inter alia* scope and definition; transparency; non-discrimination; modalities for pre-establishment based on GATS-type positive list approach; development provisions; exceptions and balance of payments safeguards; and consultation and the settlement of disputes; for an evaluation see *Kurtz*, A general investment agreement in the WTO – Lessons from Chapter 11 of the NAFTA and the OECD Multilateral Agreement on Investment, Jean Monnet Working Paper (2002), pp. 48; see also *Kentin*, Prospects for rules on investment in the new WTO round, Legal issues for economic integration (2002), p. 61 (77).

243 Some states contributing to the work of the WGTI claimed that a comprehensive multilateral instrument should be based on the General Agreement on Trade in Services (GATS), see also WTO Secretariat, Modalities for Pre-Establishment – Commitments based on a GATS-Type, Positive List Approach (WT/WGTI/W/120), 19 June 2002.

244 Generally *Mosoti*, Bilateral Investment Treaties and the possibility of a multilateral framework on investment at the WTO – are poor economics caught in between?, North-western Journal of International Law (2005), p. 95-138; *Davenport*, Investment incentives in commonwealth developed countries and the WTO investment negotiations, (2003).

245 WTO-Doc. of the Ministerial Conference, 13-18 December 2005 in Hong Kong, WT/MIN (05)/DEC.

246 See *Vandevelde*, The Economics of Bilateral Investment Treaties, Harvard International Law Journal, Vol. 41, No. 2 (2000), pp. 469.

1. The Agreement on Trade-Related Investment Measures (TRIMs)

The Uruguay Round Final Act reflects a subtle compromise[247] between varying perspectives of the negotiating parties: the TRIMs Agreement[248], which contains new disciplines for investment measures, aims at safeguarding investment benefits for national economy and development[249]. The main purpose of the agreement is to prohibit discrimination between imported and domestic goods. It applies to investment measures related to trade in goods, but not to general issues in the field and prohibits certain of these measures.[250] As the TRIMs is no comprehensive agreement and partly linked to the GATT, the respective measures need to be consistent with the national treatment obligations of the GATT[251] according to Article III[252] and XI[253] of GATT 94 as foreseen in Article 2 TRIMs[254]. An illustrative list[255] has been attached to the TRIMs listing examples of potential measures considered inconsis-

247 The compromise eventually reached during the negotiations is essentially limited to an interpretation and clarification of the application to trade-related investment measures of GATT provisions on national treatment for imported goods (Article III) and on quantitative restrictions on imports or exports (Article XI).

248 Final Act Embodying the Results of the Uruguay Round of multilateral Trade Negotiations (MTN/FA), Geneva, 15 December 1993, II. 7 "Agreement on Trade-Related Investment Measures", which came into effect on 1 January 1995; thus, the TRIMs Agreement does not cover many of the measures that were discussed in the Uruguay Round negotiations, such as export performance and transfer of technology requirements.

249 These measures are inter alia local content, local manufacturing requirements, trade balance targets, production mandates, foreign exchange restrictions, mandatory technology transfer requirements and equity restrictions.

250 *Rai*, Trade Related Investment Measures under the WTO, The Indian Journal of International Law, vol. 41, No. 3 (2001), p. 435-477; OECD Working Paper, Working Paper on International Investment, Relationship between International Investment Agreements, p. 7.

251 This concerns the treatment of imported goods versus domestic goods.

252 National Treatment.

253 See Article 1 TRIMs: Prohibition on quotas and other measures prohibiting or restricting the importation, exportation or sale for export of any product, except for duties, taxes or other charges.

254 See Panel WT/DS4/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para 14.61.

255 The list is non-exhaustive but provides a very concise definition of the respective measures including local content, sourcing and some trade-balancing requirements, which violate national treatment, and import and export restrictions, which violate the ban on quantitative restrictions, see Article XI of the GATT. In the case discussed below the panel stated moreover that "[A]n examination of whether the measures (in question) are covered by Item (1) of the Illustrative List … will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 GATT and thus in violation of Article 2.1 of the TRIMS Agreement, see Panel Report, *Indonesia-Certain Measures Affecting the Automobile Industry*, para 14.83.

tent with Article III:4 or Article XI:1 of the GATT 94[256]. In addition, the TRIMs provides for a transition period[257], during which properly notified measures are not regarded inconsistent with GATT 94[258]. By now, however, all non-conforming measures should have been eliminated, but a number of waivers have been granted to some states[259].

In spite of the cautious approach of the TRIMs to comprehensive investment provisions, the WTO panels were invoked to decide on conflicts based on an interpretation of TRIMs provisions. Yet, it was considerably notable that the panels largely attempted to avoid considering claims under the TRIMs by choosing to consider the related claims of violation of national treatment prior to examine alleged violations of TRIMs. Nevertheless, one of the first cases where the issue of foreign investment was brought on the table by a panel was the Case *Indonesia- Certain Measures Affecting the Automobile Industry*[260]. Pursuant to an *Indonesian Car Programme* tax benefits were linked to domestic content requirements applicably solely to cars produced and manufactured in Indonesia. In addition, custom duty benefits for imported components for cars were also linked to similar domestic content requirements. The panel regarded these local content requirements as *investment measures* because they had a significant impact on investment in the automotive sector[261] and considered them *trade-related* because they affected trade[262]. As a result, the *Indonesian car programme* providing for local content requirements was considered a breach of

256 The Annex shall "provide additional guidance as to the identification of certain measures considered to be inconsistent with GATT Article III: 4 and XI: 1 of the GATT 1994". Panel Report, *India-Auto Sector*, para 7.157. The *India-Auto Sector* Case involved a TRIM requiring "trade balancing". Domestic auto manufactures were allowed to import components and parts conditioned on a certain FOB (free on board) value of exports of cars and components over the same period. The panel addressed this measure considering it a restriction, contrary to the terms of Article XI: 1 (paras 7.277-7.278). After finding the trade balancing requirements violate GATT Article X: 1, the *India-Auto Sector* panel invoked the principle of judicial economy and concluded that it was not necessary to analyse the measures under the TRIMS Agreement.

257 In accordance with Article 5.2-5; moreover, Article 5:4 contains a "*stand-still*" obligation, see *Senti*, WTO – Regulation of World trade after the Uruguay Round (1998), para 1147; *Stoll*, WTO-Handbuch – Welthandelsordnung und Welthandelsrecht (2006), Chapter C.I.6, para 24.

258 In this respect, the TRIMS Agreement is a "*one-stop shop*".

259 In particular Columbia and Thailand benefit from a waiver. The measures in question were to be lifted by the end of 2003 at the latest.

260 Panel Report*, Indonesia - Certain Measures Affecting the Automobile Industry,* WT/DS54/R, WT/DS55/R, WT/DS59/R, paras 14.97-14, 99; *Falke*, Vertragskonkurrenz und Vertragskonflikt im Recht der WTO: Erste Erfahrungen der Rechtsprechung 1995-1999, ZEuS 2000, 307.

261 *Id.* para 14.80.

262 *Id.* para 14.82; The panel also held that compliance with the requirements for the purchase and use of products of domestic origin was necessary to obtain the tax and customs duty benefits and those benefits were advantages within the meaning of the Illustrative List, see *ibid* paras 14.89-14.91.

the TRIMS Agreement[263]. Another panel decision dealing with a potential violation of TRIMs obligations was the *India-Auto* Case[264], where the panel found a breach of the national treatment obligation[265]. The panel followed the common strategy to avoid addressing a potential breach of TRIMs obligations directly and thus considered the allegations regarding the TRIMs solely on the basis of *judicial economy*[266]. Referring to the case, the panel stated that "the TRIMs Agreement might not be considered more specific than the GATT Article III:4", which seems peculiar, as the TRIMS, only applicable to a specified subset of investment measures, appears to be an elaboration of Article III:4 GATT 94[267].

Perhaps the most significant development with respect to investment was a ruling by a panel in a dispute settlement proceeding between the United States and Canada: the *FIRA Panel* Decision[268]. The decision is the only case concerning foreign investment measures directly as a GATT dispute settlement panel considered a complaint by the United States regarding specific types of undertakings which were required from foreign investors by the Canadian authorities as conditions for the approval of investment projects. At issue was the "Canadian Foreign Investment Review Act", which established a governmental agency, the Foreign Investment Agency. The Agency's task was to evaluate investment applications submitted by

263 *Id.* para 14.91; Therefore any measure affecting investment matters should be regarded as an investment measure falling within the scope of the TRIMS Agreement, see Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para 14.80: "On the basis of our reading of these measures which have investment objectives and investment features and which refer to investment programmes, we find that these measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia."

264 *India-Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R (21 December 2001).

265 *India-Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R (21 December 2001).

266 Paras 7.151-7.161; the respective approach seems to be based to some extent on the considerably superficial discussion of TRIMs in the early Bananas Case, see *EC-Bananas III*, Report of the Panel, para 7.186, where the Panel, however, considered the claims simultaneously; in the Canada-Auto dispute [*Canada-Certain Measures Affecting the Automotive Industry*, WT/DS139/R (11 February 2000)], the Panel ruled moreover that the particular measure in question did not result in a breach of the national treatment Article III:4 of GATT, and therefore there could be no violation of the TRIMs Agreement, see para 10.150.

267 In the *Canada-Autos* dispute (WT/DS139/R), the panel rejected an argument by Canada concluding that a different aspect of its policies did not bring about a breach of Article III: 4 since the questionable measure was not listed in the TRIMs illustrative list of investment measures. Referring thereto the panel stated that since the list was non-exhaustive, the fact that a particular measure was not on the list expressed nothing in itself about whether the measure could be a national treatment violation, at para 10.89; the assumption that it is appropriate to consider a claim of national treatment violation prior to a claim of TRIMs violation appears at odds with the view of the Appellate Body in the *Sardines* case that claims under an agreement considered as *lex specialis* ought to be considered prior to those under the more general norms like national treatment; this view is also found in the early Appellate Body ruling in *Bananas*.

268 *Canada Administration of the Foreign Investment Review Act* (FIRA), BISD 30S/140 (1984).

foreign investors. Applications were followed when investment could carry out a significant benefit for the country itself focusing on the advancement of national industrial and economic policies. The purchase of certain products from domestic sources were determined as well as the export of a certain amount or percentage of output in the sense of an export performance requirement. The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations[269]. The panel decision in the *FIRA* case was significant in that it confirmed that existing obligations under the GATT were applicable to performance requirements imposed by governments in an investment context in so far as such requirements involve trade-distorting measures. But summarizing the impact of the TRIMs, it appears that it merely emphasizes the validity of rules already in force under the GATT and does therefore not carry much of development on foreign investment protection.

2. The General Agreement on Trade in Services (GATS)

As services are not covered by the GATT but play a significant role in contemporary international trade, the WTO system required the adoption of a new, separate and comprehensive agreement concerning trade in services. The *General Agreement on Trade in Services* (GATS) has partly been modelled on the GATT and mirrors its structure widely. Of all WTO agreements, the GATS addresses investment issues most directly[270]. In parallel to the GATT, some GATS provisions provide for most favoured nation (MFN) standards[271] and national treatment[272].

In accordance with the MFN obligation, service suppliers from one member state must not be treated in a less favourable way than like services and service providers from any other member state which is regarded as an "immediate" and "unconditional" obligation[273]. National treatment, however, applies only to scheduled sectors. The GATS aims at liberalization in trade in services and contains therefore provisions concerning general obligations and disciplines and provisions concerning additional standards applicable in liberalized sectors. The GATS provisions do not

269 Canada Administration of the Foreign Investment Review Act (FIRA), BISD 30S/140 (1984), *ibid.*

270 OECD Working Paper, Working Papers on International Investment, Relationships between International Investment Agreements (2004), p. 6.

271 See Article II GATS.

272 See Article XVII GATS.

273 Part II: "General Obligations and Disciplines", Article II Most-Favoured-Nation Treatment, paragraph 1 reads: "with respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and services suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country".

deal with investment directly, but the issue is being dealt with through the term of a "commercial presence mode of supply", which is in essence an investment activity. Commercial presence in the sense of the provisions requires the establishment of commercial presence in the country where the service is supplied, which is therefore, in fact, a mechanism to provide market access[274]. Due to its inherent flexibility the GATS was considered to serve as a role model for the comprehensive multilateral agreement and thus simply to extend the GATS style approach[275]. But the suggested GATS style approach to liberalization holds various weaknesses: the level of liberalization might place constant pressure on certain countries to open sectors for liberalization and under the GATS countries are subject to uncertain terms for GATS rules are only poorly defined. Finally, negotiations under the GATS are bilateral, while a substantive agreement would bind multilaterally and create obligations in that sense.

3. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)

The *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPs) was initiated to address the growing importance of intellectual property rights and is therefore heading at adequately protecting intellectual property rights. The agreement is building upon existing intellectual property conventions[276] and provides for both, national treatment and MFN for the protection of specific sectors[277]. It contains three different sets of provisions, but none addresses issues of investment[278]. Yet, it helps to open up economies to foreign investment by protecting technology which

274 The WTO members can impose restrictions with respect to the commercial presence through e.g. a limitation of the number of economic operators (Article XVI GATS) or take exceptions from MFN to foreign services suppliers or from the obligation to accord national treatment (Article II:2 and Article XVII GATS).

275 As a consequence, this would mean the subjection of sectors to liberalization, while other exceptions and qualifications would be maintained.

276 Such conventions include the 1971 Berne Convention for the Protection of Literary and Artistic Works, the 1967 Paris Convention for the Protection of Industrial Property, the 1961 Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations, 1961, and the 1989 Washington Convention on Intellectual Property in respect of Integrated Circuits.

277 Such as copyright, patents, trademarks, etc.

278 The different sets of provisions are (1) institutional arrangements and procedures to deal with intellectual property matters within the WTO system, (2) substantive standards relating to intellectual property rights and (3) standards for enforcement of such rights.

plays an important role for investment abroad[279]. In addition, the TRIPs provides standards of protection which are also comprised by the scope of investment in regional and bilateral investment treaties. The respective rights are created in domestic law and apply within these legal systems, as the TRIPs determines standards that are supposed to be transformed into national law. Holders of these rights are entitled to benefit from certain standards with respect to the domestic enforcement structures and their rights in terms of access to judicial remedies[280]. A breach of such standards does not imply a failure to an obligation resulting out of an international treaty, but has to be addressed in national and domestic law[281].

III. Summary

Adding investment to the WTO agenda clearly goes beyond the traditional notion of trade and thus indicates an inclination to broaden the scope of the WTO system in order to comprise general commercial issues as well. Negotiations on a "General Agreement on Investment", however, have an advantage as compared with other *fora* because of their capacity for trade-offs with other fields, such as intellectual property and trade in services. But it also sparked a contentious and complex debate within the system and the approach of the WTO system to draft a multilateral comprehensive regime on foreign investment has been challenged consistently. The recent history of the WTO may explain some of the circumstances, but in this context the question must be raised as to the benefits which would result from the drafting of a multilateral comprehensive agreement by the WTO. The attempts to negotiate such an instrument failed, however, and have been struck off the agenda since. At the present period the drafting of such a regime is being put on hold. Still, various benefits of such multilateral agreement could be asserted: A comprehensive investment agreement would provide for both, greater transparency and well-defined investor rights, and could thereby bring order to international investment law. Trade and investment are connected by a close linkage, which would be reflected in a comprehensive multilateral investment agreement drafted by the WTO. Ultimately, a substantive multilateral investment agreement may increase investment flows, in particular to developing countries.

279 See *Burt*, Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization, 12 Am.U. Int'l L. Rev. 1015, 1039 (1997), stating that "[t]he transfers of technology accompany the great majority of foreign investment from multinational corporations in home countries to their subsidiaries in host countries" and the protection of technology "[r]emoves another source of insecurity for foreign investors and promotes the transfer of technology between countries, in particular between developed and developing countries", *ibid.* at 1039.

280 OECD Working Paper, Working Papers on International Investment, Relationships between International Investment Agreements (2004), p. 7.

281 Conversely, investment treaties create such international obligations.

But the approach of the WTO to negotiate a comprehensive agreement on foreign investment also meets strong criticism, based on the idea of the different concepts and goals of international trade law and investment law. Including an agreement on foreign investment into the WTO system would require a basic equal concept of investment law and trade law. This is lacking. Despite the close linkage between trade and investment their diversity with regard to goals and achievements predominates. The WTO has its competence in trade issues and the principles governing trade are not suitable for investment[282]. In view of this situation, it can be stated that an investment agreement does not belong into the WTO system, because it simply might not be the right forum for a multilateral investment agreement. The factors stability, policy predictability and finally profit cannot be guaranteed by an investment agreement, but are of high importance for the success of investment abroad. In addition, there is no empirical proof that an investment agreement would promote foreign investment or increase investment flows. Another point of criticism is based on the fact that the mission of the WTO is of a fundamentally liberalizing character. This is a substantial objection to draft an instrument without such liberalization as its main object. Another weakness of the WTO system is its adherence to solely interstate remedies, which might be not as enforcement effective as the investor-state dispute resolution system under the ICSID.

The issues raised here mirror first and foremost the interests of an investor, and the question as to whether the WTO is the appropriate venue for an international investment agreement implies at first place the question where one is needed. From an investor's perspective, undertakings in certain developing countries bring about an immense risk with regard to potential rates of return and the WTO does not provide for the respective dispute settlement and enforcement processes. After all, it seems unlikely that negotiations on a comprehensive investment agreement will be able to proceed since there is no consensus on modalities, both procedural and substantive.

E. Conclusion

The roles of human rights institutions and the WTO in the context of foreign investment protection have been at issue in this paper and as a debate over the roles of these mechanisms in the context of foreign investment protection suggests, they, as mechanisms, seem only second choice when foreign investment litigation or arbitration is considered. Nevertheless, the coming period in ICSID jurisprudence is one in which the matter of consistency will be of utmost relevance. The challenge of the Argentine cases which are currently being dealt with extensively by the respective

282 In particular the application of non-discrimination and national treatment were inappropriate and would damage development. Moreover, a treaty of investors rights would be against the principle of reciprocity.

tribunals is indeed remarkable. The tribunals need to achieve a substantial degree of consistency - otherwise the ICSID might slide into a substantial crisis. Likewise, the alternative approach to foreign investment protection is given a special emphasis. The vast network of human rights conventions concluded on both regional and universal level provides for foreign property protection and non-discriminatory treatment of aliens. In particular in the regional human rights instruments, relatively effective human rights have been accorded to individuals irrespective of their nationality. As each member state can demand the respect of treaty obligations by the other member states, all are on an equal footing. Consequently, no state rights as such are encroached upon in case of a violation of such human rights held by any individual, but , a state party to a human rights convention can provide assistance to its national in order to secure his/her treaty rights. Thus the assistance is not different from any other state may provide. Given this assumption the rule of diplomatic protection in its classical conceptual inter-state understanding is not applicable. The state rather has to apply human rights assistance in the sense presented above, which is based on treaty law and limited to the means provided by the particular treaty. Ultimately, the prerequisites for diplomatic protection - especially the local remedies rule - and various legal limitations on the means of protection help to prevent an overly frequent use and abuses by powerful states.

Like any other mode the idea of investment protection by means of human rights institutions and human rights assistance is open to criticism. Obviously, the instrument of diplomatic protection and the concept of human rights assistance are founded on somewhat different bases and the expectation that the instrument of diplomatic protection would become superfluous through the new generation of human rights conventions has not been fulfilled. On the international plane, the individual has no equivalent corresponding procedural rights to achieve the respect of the substantive rights provided for in the human rights treaties. The ECHR might serve as an exception, since every member state acknowledged jurisdiction of the ECtHR. From the current perspective these treaties establish quite far reaching substantive rights for individuals but not as a corresponding basis for diplomatic protection by their home countries. This has proved to be ineffective due to failures in the institutional system of the respective treaty and the unwillingness of states to observe international treaty obligations. Yet, there is no general obligation for all states to submit their relevant disputes to a peaceful settlement through the binding decision of an independent and neutral authority. In particular in the field of foreign investment protection with its inherent underlying risks, there is a strong need for reliance on effective remedies and even more effective enforcement mechanisms.

One characteristic element of foreign investment law is that several concepts diverging with regard to their goal and nature are at clash at every moment. Foreign investment law and the protection of foreign investment are shaped by the goal of avoiding or at least reducing the element of risk for the investor in a long-term project. Safeguarding foreign investment undertakings is the core idea of the law on international investment protection, while human rights law as provided for by the new type of human rights treaties aims at the independence of the individual from

the state with regard to the protection of human rights. Instead, trade law focuses on liberalisation for the exchange of goods. International investment law needs to comprise elements of all of these concepts, and as with most clashes of legal concepts, there will be no complete triumph of any conceptual approach. This assessment is backed and mirrored by the current developments of international investment litigation. In the light of the preceding analysis the paper argues that foreign investment protection as provided for by the ICSID system is, in spite of its current crisis, not at all a bad outcome. The advantages of arbitrating under the auspices of the ICSID are manifold and it seems unlikely that the mechanisms offered by human rights institutions as well as the WTO can be considered as equal to ICSID. Each mechanism to protect foreign investment has to follow its own course in serving their task of foreign property protection, although sometimes their courses may run parallel.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Comment by *Sabine Konrad*[*]

A. Introduction

I would like to address two questions:

- Is the European Convention of Human Rights (the "ECHR" or the "Convention") an instrument of investment protection, and
- Is there something to be learned from the ECHR on the topic of the state's right to regulate as opposed the rights of the investor to protection?

B. The ECHR as an Instrument of Investment Protection

The ECHR is certainly not an instrument of investment protection in the formal sense.

However, the Convention has specific elements of investment protection in addition to the general protection of Human Rights of nationals and non-nationals alike. The case law of the Strasbourg court confirms this.

At a conference on "Stocktaking after 40 years" of ICSID, it is perhaps fitting to refer to a seminal case on the Convention's regime on expropriation which is 20 years old: *Lithgow vs UK*[1].

Article 1 of Protocol No 1 to the Convention contains the right to property and deals with expropriation.

Its relevant passage reads:

"No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."

The court held in *James vs UK*[2] and *Lithgow vs UK* that there are two different regimes, one for national and one for non-national investors. Whereas non-nationals are entitled to protection by the general principles of international law, including

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1 *Lithgow and Others v. the United Kingdom,* judgment of 8 July 1986, ECHR, Series A No. 102.

2 *James and Others v. the United Kingdom*, judgment of 21 February 1986, ECHR, Series A No. 98.

inter alia a right to compensation under the *Hull*-doctrine, nationals are not; for nationals, a right to compensation exists only as an emanation of the proportionality requirement. Thus only the regime for non-nationals is comparable to protection under a BIT.

Since most of its cases concern expropriation of the property of nationals, the case law of the European Court of Human Rights on expropriation has to be looked at with caution. Nonetheless it is possible to point to investment protection-type cases under the ECHR regime.

One example is *Sovtransavto Holding* vs Ukraine.[3]

This case concerns the rights of a Russian minority shareholder, *Sovtransavto*, in an Ukrainian public limited company, *Sovtransavto-Lugansk*. The management of *Sovtransavto-Lugansk* increased the shares of *Sovtransavto-Lugansk* thereby reducing the overall shareholding of Sovtransavto from 49% to just under 21%, in effect curtailing *Sovtransavto's* voting rights and taking control of the company. It further appears assets of *Sovtransavto-Lugansk* were sold to various entities set up by its managing director.

The investor challenged the actions of the management of *Sotransavto-Lugansk* in the national courts. The President of Ukraine in person interceded on behalf of the government in the court proceedings citing "national interests". This was done at the instigation of the management of the Ukrainian company, which by this time had become a private company. The investor lost his case and subsequent appeals. Ultimately *Sotransavto-Lugansk* was wound up and the investor received payments which "had not been in proportion to its initial 49% shareholding".

Had *Sovtransavto's* shareholding in question been an investment in the Energy Sector or had the 1998 Russian-Ukraine BIT of 17 November 1998 been in force (as of December 2006 it has yet to be implemented), *Sovtransavto* would surely have travelled the BIT route. It can be speculated that it went to the European Court of Human Rights – where it won - precisely because neither of these two avenues was available to it.

Sovtransavto did exactly what the European Court of Human Rights suggested in *Lithgow*: it employed the convention mechanism for investment protection. In the words of *Lithgow*:

"[The reference to general principles of international law] enables non-nationals to resort directly to the machinery of the Convention to enforce their rights on the basis of the relevant principles of international law, whereas otherwise they would have to seek recourse to diplomatic channels or to other available means of dispute settlement to do so."[4]

Article1 (1) 2nd sentence of Protocol No 1 is not an umbrella clause that "mirrors" customary law rules on expropriation of property belonging to non-nationals. It

3 *Sovtransavto Holding v. Ukraine*, No. 48553/99, ECHR 2002-VII.
4 *Infra.*, paragraph 115.

imports standards of customary international law into the Convention. The effects, however, are equivalent.

C. The Convention Perspective on the State's Right to Regulate

It is also worth observing that the *Lithgow* judgment contains a very interesting explanation of the difference between the protection of property rights afforded to nationals and non-nationals under the ECHR:

"Especially as regards a taking of property effected in the context of a social reform or an economic restructuring, there may well be good grounds for drawing a distinction between nationals and non-nationals as far as compensation is concerned. To begin with, non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals".[5]

This explanation is based on two reasons for differential treatment:

- The first is what one might call the 'Boston Tea Party' rule: "No regulation without representation."
- The second reason is the fact that the national of the State in question is a member of the public in whose interest the measure has been taken; a consideration which is not relevant in the case of a non-national. The non-national has invested in the country but is not necessarily integrated to such an extent that he would enjoy the benefits of the regulation.

Both reasons are relevant in the context of the present discussion on a host state's right to regulate in a BIT context. They militate for investor protection and against

5 Supra., paragraph 116. The *Lithgow* arguments are echoed by *Paulsson* in support of a general distinction between human rights and investment protection. He does not address Article 1 of Protocol 1, which provides for a distinction between national and non-nationals; *Paulsson*, "Indirect expropriation is the right to regulate at risk," at the joint UNCTAD, OECD and ICSID Conference "Making the Most of International Investment Agreements", 12 December 2005, http://www.oecd.org/document/1/0,2340,en_2649_33783766_35501697_1_1_1_1 ,00.html.

an unlimited right of the host state to regulate unless such a regulation is combined with an obligation to compensate if investor and investment specific considerations so required. This 20 year-old reasoning in *Lithgow* is fresh as well as topical and it deserves to be explored further.

Investment Protection by Other Mechanism: The Role of Human Rights Institutions and the WTO

Comment by *Rudolf Dolzer*[*]

Our speaker has presented an impressive panorama of the diversity of international rules governing private property. These rules emanate from customary international law governing aliens, from the body of rules protecting human rights, from treaties regulating international trade and from conventions on the promotion and protection of foreign investment. Even a cursory consideration of the various rules on property as contained in these diverse areas of international law points to differences and to divergences in their content and the level of protection granted to the owners of the property.

In view of these obvious differences, the question will be raised whether the differentiations must be seen as undesirable fragmentations of diverse lawyers of international law in need of a comprehensive synthesis or as expressions of appropriate distinctions inherent in the diversity of objectives of international law. The debate on the possible integration of a future global investment regime into the scheme of the World Trade Organisation has carried overtones of the view that more integration is necessary and that the diversity of the existing rules will need to be reconsidered. Also, the occasional drawing of analogies, in the legal analysis of individual issues, from one of the four areas to another one, has implicitly assumed that uniformity among these areas is appropriate and desirable.

In my own view, the diversity of the rules echoes the diversity of objectives, and there is no reason to alter the existing scheme of rules. All of the four areas have their own legal characteristics. Customary law regarding the status of property held by an alien is an expression of the minimum standard of decency and civilisation which states have come to expect from each other and which each state has to accept as a member of the community of nations. The rules on property contained in human rights investment are meant to reflect and secure the well-being and the dignity of each person which a state has to respect in its treatment of all persons, including its own nationals. Trade law essentially focuses on creating a level playing field for all actors involved in the international exchange of goods, allowing for sound competition and the optimal allocation of resources. And, again different, treaties on foreign investment aim a reducing the political risks of the foreign investor who acquires an

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investment, often for high initial costs and expects a fair rate of return, often over a long period.

Thus, the differences in the content of the rules are dictated by the different objectives, and they cannot be seen as accidental characteristics of uncoordinated fragmentation. Specific conclusions result from this diversity inherent in the difference of goals.

On the doctrinal level, every effort to draw analogies between the different fields in principle runs the danger to ignore the differences in the legal context and purpose of each set of rules. Under certain circumstances, cross-references may still be possible; for instance, it is reasonable to assume that the standard afforded in an investment treaty will not be lower than the protection afforded in a human rights agreement. An example of the limits of drawing on the notions and results in other fields concern the understanding of the requirement of national treatment which at first sight would seem to be identical in all areas concerned. However, recent jurisprudence convincingly demonstrates that the legal context of trade rules and investment rules does not permit analogies in every case and indeed may require different approaches (see *R. Dolzer*, National Treatment, OECD 2005).

Given the diversity of purpose and objective, an effort to synthesize and harmonize or unify the rules concerned seems neither possible nor desirable. With regard to the difference between the status of human rights and the law of aliens, in particular, it is reasonable to assume that the difference will remain existent for the foreseeable future.

Consistent with my emphasis on the fact that the differences are inherent in nature, I am also sceptical on any effort to bring trade and investment rules under one organizational roof. Of course, it may be argued that both areas should retain their characteristics and nevertheless be managed by the same organization, in concreto the World Trade Organization. In my view, the advantages of such a re-organization are not apparent. In the first place, it seems to be obvious that the WTO continues to struggle with its own complexity and that an addition of a new major task such as the administration of investment rules would add to this complexity and thus lead to more stagnation, Moreover, the addition of investment rules would move the WTO into the direction of a world economic organization, in danger of imposing uniform policies where diversity may be more appropriate and where mistakes would be multiplied in their effects. Form this perspective, the decision not to pursue global investment rules specifically within the WTO may not have to be deplored.

Our speaker has also addressed the different question whether the present patchwork of bilateral and multilateral treaties on investment might not better be replaced by a single global convention. In my view, it is in any event useful to separate this question from the issue of an institutional link with the WTO and to consider it on its own merits. At first sight at least, it is far from obvious why a global framework would be appropriate for trade matters but not for the rules on investment. This is so especially today when developing states no longer see investment treaties as an undue impediment to their economic sovereignty but as an entrance card to the growing international markets of foreign investment and thus to gain access to fo-

reign capital and know how. In recent years, developing states have concluded more investment treaties among themselves than with industrialised states. In my view, a global convention, if accepted widely, would also contribute to introduce and strengthen those disciplines necessary for good governance in the host states and thus to contribute to growth and the reduction of poverty in countries and regions which have fallen behind in the competition for foreign investment in the past decade, in particular in Africa. Finally, a global agreement could replace the current multitude of rules with much more simplicity and transparency.

It is not overlooked her that the negotiation of a global investment convention, outside the WTO would face major hurdles. Firstly, the time and effort needed for such negotiations would be enormous. Secondly, the industrialized countries would not be inclined to accept a convention providing less protection than their bilateral treaty programmes, while developing countries might be inclined to further insist on regulatory space for changing policy concepts. The issue of the further status of the existing treaties would also have to be resolved on another level, even among industrialized countries, significant differences in their policies remain, particularly in regard to the function of treaties as a vehicle for the opening of domestic markets. Given these open issues, it remains a matter of political will whether or not a new round of negotiation should be opened for a global investment treaty, this time outside the WTO. It is true that after the failures within the OECD in the 90's and within the WTO more recently, a certain fatigue to renew these efforts has taken over, not surprisingly. At the same time, the advantages of a global investment treaty remain on the table, and the topic remains on the international economic agenda.